SUPREME COURT, U. S.
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In the Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1889

ESTATE OF LEONARD E. WHITLOCK, DECEASED, GEORGIA M. WHITLOCK, EXECUTRIX, AND GEORGIA M. WHITLOCK,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Petitioners petition for writ of certiorari to review judgments of United States Court of Appeals for the Tenth Circuit in these cases.

OPINIONS BELOW

Findings of fact and opinions of United States Tax Court are reported in 59 TC 490 (Appendix A, infra, pp. A1-A46). Opinion of Court of Appeals (Appendix B, infra, pp. A47-A56), reversing Tax Court in Docket No. 73-1497, and affirming Tax Court in Docket No. 73-1498 is reported at ..... F.2d ....., 74-1 USTC 9388.

JURISDICTION

Judgments of the Court of Appeals were entered on April 22, 1974 (Appendix C, infra, pp. A57-A58). Petition for rehearing by Court In Banc, timely filed, was denied by Court of Appeals on 22nd day of May, 1974 (Appendix D, infra, pp. A59-A60). Jurisdiction of this Court is invoked under Title 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether, by reason of plain and explicit wording of Section 951(d) of Internal Revenue Code of 1954, Title 26, U.S.C., a United States shareholder who, for his taxable year, is subject to tax under Section 551(b) of said Revenue Code, relating to foreign personal holding company income included in gross income of United States shareholders, on income of a controlled foreign corporation is required to include in his gross income, for such tax year, any amount under Subsection (a) of Section 951 of Internal Revenue Code of 1954 relating to inclusion in gross income, by shareholders of controlled foreign corporation, of pro-rata share of increase in investments in U.S. property by controlled foreign corporation.

2. Whether, a United States shareholder of a controlled foreign corporation described in Section 951(a) of Internal Revenue Code of 1954, Title 26, U.S.C., is required to include in gross income his pro-rata share of the corporation's increase in earnings invested in U.S. property, where those earning were accumulated by the corporation prior to January 1, 1963.

3. Whether provisions of Section 951(a)(1)(B) of Internal Revenue Code of 1954, requiring inclusion in gross

income of a United States shareholder in a controlled foreign corporation of a pro-rata share of said corporation's increase in earnings invested in United States property violate provisions of Article I, Section 2, Clause 3, and Article I, Section 9, Clause 4 of United States Constitution, as a direct tax on items which were not income of corporate shareholder and thus amount to direct tax, unapportioned among the states and a tax on something which does not constitute income to shareholders of such a corporation; alternately, whether such provisions requiring such inclusion violate Fifth Amendment to United States Constitution by creating an irrebuttable presumption of receipt of income under specified circumstances, and thus amount to deprivation of property without due process of law.

4. Finally, whether petitioners, by complying with provisions of Section 6038 of the Internal Revenue Code of 1954, Title 26, U.S.C., and Regulation Sec. 1.6038-2(a), (i), 26 CFR, by filing with their 1963 tax return a form 2952 disclosing existence of a controlled foreign corporation, its address, its shareholders residing in the United States as citizens, its 1963 income, and balance sheet showing accounts and notes receivable, and stock investments, gave to Commissioner of Internal Revenue a sufficient "clue" to indicate that a further audit of 1963 return was required, sc as to raise bar of Statute of Limitations for year 1963 under stipulated facts involved, pursuant to Section 6501 of Internal Revenue Code of 1954, Title 26, U.S.C.?

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED

Constitutional provisions, statutes and regulations involved with reference to the above issues are primarily (Appendix E, infra, pp. A61-A77):

Issue 1. Section 951(a)(1)(B), Section 951(d) and its companion Section 951(c), Section 956(a)(1), (2) of Internal Revenue Code of 1954, Title 26, U.S.C., particularly Section 951(d), Section 1247(a) and Section 551(b) of Internal Revenue Code of 1954, Title 26, U.S.C., relating to taxation of shareholders of a foreign personal holding company, along with Regulations Sec. 1.951-2, Sec. 1.951-1, and Sec. 1.951-3, 26 CFR.

Issue 2. Section 951(a)(1)(B), Section 956(a)(1) and (2), Section 956(b), Section 951(d), and Section 1248, all of the Internal Revenue Code of 1954.

Issue 3. Section 951(a)(1)(B), Section 956(a), (b), Section 957(a), (d), along with Article I, Section 2, Clause 3, and Article I, Section 9, Clause 4, all of U.S. Constitution, along with Fifth and Sixteenth Amendments to U.S. Constitution.

Issue 4. Section 6501(a) and (e), Section 6038, all of Internal Revenue Code of 1954, and Regulation Sec. 1.6038-2(a), (i), 26 CFR.

STATEMENT

Case in the United States Tax Court (hereafter referred to as Tax Court), which served as basis for this litigation, was tried on basis of joint stipulation of facts filed, with Exhibits attached, all of which are part of Tax Court record, together with introduction into record by petitioners below of certain items pertaining to legislative history of controlled foreign corporation provisions of Internal Revenue Code, of which Tax Court was asked to take judicial notice. These exhibits were admitted into evidence, without opposition by respondent below. Tax Court found that summarized:

During the years involved in this proceeding Leonard E. Whitlock and Georgia M. Whitlock were husband and wife residing in Stafford, Kans. Leonard E. Whitlock died on October 11, 1967, while a resident of Stafford, Kans. On January 5, 1968, Georgia M. Whitlock, his widow, was duly appointed executrix of the Estate of Leonard E. Whitlock by the Probate Court of Stafford County, Kans. Since then she has acted in that capacity and is the duly qualified and still acting executrix of the Estate of Leonard E. Whitlock. At the time she filed petition for redetermination in this case, she resided in Stafford, Kans.

Taxpayers filed joint Federal income tax returns for calendar years 1963 and 1964 with District Director of Internal Revenue in Wichita, Kans., and filed a joint Federal income tax return for calendar year 1965 with District Director of Internal Revenue in Dallas, Tex. After Leonard's death, Georgia filed a joint Federal income tax return for taxable year 1967 for Leonard E. Whitlock, deceased, and Georgia M. Whitlock with District Director of Internal Revenue in Wichita, Kans. All of these returns were filed on the cash basis.

During years 1963 through 1967, Leonard (until time of his death) and Georgia were both U.S. citizens.

Whitlock Oil Services, Inc. (hereinafter referred to as Oil Services), was a foreign corporation incorporated under laws of Republic of Panama. For each of its taxable years 1963 through 1967, Oil Services' taxable year was the calendar year.

During 1963 and 1964, petitioners, as joint tenants with right of survivorship, owned all of Oil Services' stock. During first half of 1965 Leonard relinquished all of his interest in Oil Services' stock and thereafter, during last half of 1965, all of 1966 and all of 1967 Georgia held all of Oil Services' stock.

At a point of time during years 1963 through 1967, Oil Services held investments in United States property, acquired after January 1, 1963, and at same time had earnings and profits, primarily and essentially accumulated *prior to January 1, 1963,* which were sufficient so that they did not limit amounts, *if any,* otherwise includible in petitioner's gross income under Section 951(a), if such section is applicable.

Prior to 1964, Oil Services had never been a foreign personal holding company within meaning of Section 552 of Internal Revenue Code of 1954, nor had its shareholders included in gross income any amount under Section 951 with respect to that corporation, prior to 1964.

However, during years 1964 through 1967, Oil Services was a foreign personal holding company as defined in Section 552 of Internal Revenue Code of 1954, and during those years Oil Services had undistributed foreign personal holding company on which shareholders were subject to tax under Section 551(b) of Internal Revenue Code of 1954.

If Sections 951(a)(1)(B) and 956(a)(1), (2) may be constitutionally applied to this case, which petitioners denied and continue to deny, the amount of $13,653.00 would have been included in their gross income for taxable year 1963, as their pro-rata share of Oil Services' increase in earnings invested in U.S. property in 1963. Aforesaid amount, which was omitted, as a number or figure, from petitioners' gross income on their 1963 joint Federal income tax return, is in excess of 25% of amount of gross income stated in that return as a number or a figure.

Petitioners did not file any consent extending period of limitations in connection with year 1963. They attached to their 1963 return an "Information Return With Respect to Controlled Foreign Corporations", being a form 2952,

revised December, 1963, in form devised and required by Commissioner of Internal Revenue, which form disclosed fact that Oil Services was a controlled foreign corporation, its address, extent of ownership by its shareholders, a statement of its income for year 1963 and balance sheet of corporation which showed assets which included notes receivable, accounts receivable, investments in common stocks and other items. There was no formal statement on this information return as to name or location of companies or individuals involved in said notes and accounts receivable and investments in common stock. Such formal naming and location is not required on the return in question. There was a statement on page 2 of form 2952, line (g) that amounts were loaned to United States person filing return of $15,975 and to any corporation controlled by U. S. person filing return of $76,808.88 (later essentially repaid). See page 92 of Appendix filed in U.S.C.A. 10.

In general, statutory framework of Internal Revenue Code of 1954 does not reach out to tax foreign-source income of a foreign corporation. However, where such a corporation is controlled by U.S. interests, the corporation's U.S. shareholders may, under technical reading of two different parts of the Internal Revenue Code, be obligated to include all or part of the corporation's income and earnings as their own. Foreign personal holding company provisions of Section 551(a) by their technical reading, require shareholders of a foreign personal holding company to include in their taxable U.S. income their pro-rata share of undistributed foreign personal holding company income of such a corporation. Further, controlled foreign corporation provisions of Sections 951 et sequitur, sometimes loosely referred to as Subpart F, defines several areas where foreign corporation's income may be attributed to its U.S. shareholders.

The area, with which this litigation is specifically involved, is the area of inclusion covered by Section 951(a)(1)(B), Section 956(a), (b), and Section 957(a), (d) of Internal Revenue Code of 1954. These sections, collectively, would require a United States person, who owns 10% or more of total combined voting power of all classes of stock of a controlled foreign corporation on the last day of the corporation's tax year, to include in his gross income his pro-rata share of the corporation's increase in its earnings invested in United States property by it. Such foreign corporation must have been controlled (but *not* necessarily by the person involved) for an uninterrupted period of 30 days or more during any tax year beginning after December 31, 1962, and with control meaning that 50% or more of total combined voting power of all classes of stock entitled to vote is owned by a United States shareholder or shareholders *on any day* during the taxable year of the corporation. There is *no* requirement that these shareholders be the same as shareholders who own stock on last day of year.

Tax. under this set of provisions, is imposed on the U.S. shareholder's pro-rata share of corporation's increase in earnings invested in U.S. property for entire year, and a computation of amount of those earnings invested is made *as of end of the year*, to extent that amount would have constituted a dividend *if it had been distributed* (Section 956(a)(1), (2) of Internal Revenue Code of 1954). Share of the U.S. stockholder in earnings so invested is determined on basis of stock owned by the shareholder on *last day of the tax year*. There is no requirement that the shareholder be one of group of shareholders who owned stock for requisite period of 30 days during which control must have existed.

There is no formal limitation in provisions of Section 951 et sequitur of Internal Revenue Code of 1954 which states that earnings invested in U.S. property are to be only the earnings acquired after December 31, 1962. However, there is a companion section of Revenue Code, Section 1248, which was adopted as a part of same legislation designed to deal with controlled foreign corporations and repatriation of their earnings, which, in general, provides that if a United States person, owning 10% or more of the total combined voting power of all classes of stock of a controlled foreign corporation at any time during a five-year period, sells or exchanges his stock in such corporation, or the corporation is liquidated, then gain recognized on sale or exchange of the stock shall be treated as a *dividend* to extent of earnings and profits of the corporation which were attributable to the stock and which were accumulated in taxable years beginning *after* December 31, 1962. This is a companion section to Section 951 et sequitur designed to accomplish the same overall purpose of Congress, in part, and by its provisions Oil Services could have been liquidated entirely on January 2, 1963, or its stock sold by its then shareholders, and result would have been entirely capital gain without inclusion of any portion of pre-1963 earnings as ordinary income.

Petitioners took following positions before United States Tax Court:

a. By *plain, unequivocal* and *clear reading of Section 951(d)*, IRC 1954, which was contended to be consistent with legislative history of act, and its companion Section 1248, IRC 1954 enacted as part of same legislation to procure the desired purpose, petitioners were clearly not subject to tax under Section 951(a) because of wording of Section 951(d).

b. In any event, based on legislative history of act, if Court was to engage in interpretation of the act, clear Congressional intent was to *exclude pre-1963 earnings* of Oil Services in measuring any liability under Section 951(a).

c. That in all events, Section 951(a) as it applied, violated provisions of Article I, Section 2, Clause 3, and Article I, Section 9, Clause 4, as a *direct tax on items which were not income of corporate shareholders, and thus was a direct tax unapportioned among States and a tax on something which does not constitute income to shareholders* (witness fact that neither stipulation filed in Tax Court, nor Tax Court findings indicate that taxpayers received income *from* corporation in amounts determined by Commissioner under Section 951(a)), and in addition, the provisions of combined Section 951(a)(1)(B) and Section 956(a)(1), and (2) violated the Fifth Amendment to the U.S. Constitution as creating an irrebuttable presumption of income.

Year 1963

d. Same position noted in b. and c. above was taken with reference to 1963, and *in addition*, taxpayer contended that three year statute of limitations outlined in Section 6501 IRC 1954 applied, because taxpayer had given a sufficient *"clue"* to Commissioner that further audit might be required, in form of a document numbered 2952, required to be furnished by both Section 6038 IRC 1954 and Regulation Sec. 1.6038-2(a) and (i), 26 CFR, so as to satisfy the "clue" rule of *Colony, Inc.* v. *Comm'r*, 357 U.S. 28, 78 S.Ct. 1033, and *Benderoff* v. *U. S.*, 398 F.2d 132 (USCA-8).

Upon this presentation in U.S. Tax Court, that Court held, by a majority opinion of *13 of the 16 judges*, with 3 judges dissenting, in a very carefully reasoned opinion by

Judge Forrester of Tax Court, of many years experience on Tax Court, that (Appendix A, infra):

a. For years 1964, 1965 and 1967, taxpayers *were not required to include in their gross income* any part of Oil Services' increase in earnings invested by Oil Services in U.S. property by reason of *plain wording of Section 951(d) IRC 1954*, and that Regulation Sec. 1.951-3, *insofar as it runs contrary to this conclusion, is invalid.* In so doing, Tax Court noted that, as in *Comm'r* v. *South Texas Lumber Co.*, 333 U.S. 496, 68 S.Ct. 695, a regulation should not be overruled, except for weighty reasons, *but* that the *statute is the primary authority*, and that regulations to extent they are in conflict with statute are void, citing *Koshland* v. *Helvering*, 298 U.S. 441, 56 S.Ct. 767. Tax Court carefully considered *legislative history of the act*, and concluded that "there is no more persuasive evidence of the statute's purpose than the words by which Congress undertook to give expression to its wishes, and here examination of the legislative history does not require a different interpretation of those words. See United States v. Amer. Trucking Ass'ns, 310 U.S. 534, 543 * * *." (l.c. 504)

b. For all years there was no constitutional bar to inclusion in income under Sections 951 et sequitur.

c. That in view of its decision on application of Section 951(d), *it was unnecessary to decide* whether act was meant to include pre-1963 earnings in determining application of Sections 951 et sequitur. Thus, it did not reach this issue.

d. For year 1963, taxpayers did not provide adequate disclosure of omitted income, despite *Colony, Inc.* v. *Comm'r, Benderoff*, etc.

Following entry of decision in Tax Court, Commissioner of Internal Revenue filed a timely appeal to United

States Court of Appeals for Tenth Circuit relating to years 1964, 1965 and 1967, on which he had lost before Tax Court Docket 73-1497. Thereafter, petitioner below filed a timely cross appeal against findings of Tax Court for year 1963 Docket 73-1498. Court of Appeals reversed decision of the Tax Court below against respondent relating to years 1964, 1965 and 1967, holding that Tax Court was in error in invalidating the provisions of Regulation Sec. 1.951-3, which would attempt to tax petitioners in this case on earnings invested in U.S. property, despite plain reading of Section 951(d) of Internal Revenue Code of 1954, and affirmed decision of Tax Court below against petitioners for year 1963 (Appendix B, infra).

JURISDICTION OF FEDERAL COURT BELOW

Residence of petitioners at time of timely filing respective notices of appeal and cross appeal from decision of Tax Court to United States Court of Appeals for Tenth Circuit was in Stafford, Kansas within jurisdiction of said Court. Jurisdiction was conferred by Title 26, U.S.C., Sections 7482, 7483. Jurisdiction of Tax Court was based on Title 26, U.S.C., Section 6213(a), and Section 7442, petition for redetermination having been timely filed.

REASONS FOR GRANTING THE WRIT OF CERTIORARI

Decision of Court of Appeals was not heard by the full Court, but heard by a panel of three judges of that Court, with rehearing in banc denied. Petitioners' counsel have been advised that sustaining of Commissioner's position in this case, if it is sustained, will result in rendering the widow involved as the litigant herein penniless and

dependent, being confronted with tax claims exceeding a quarter of a million dollars, including interest, and without having received either directly or by her deceased husband, income from the foreign corporation involved with which to pay tax liabilities asserted. Therefore, in equity, the most serious consideration of this petition for the writ is invited.

Equally important and on legal grounds, reasons why the writ should be granted are:

a. Tenth Circuit panel's decision, with reference to weight afforded a Treasury Regulation, conflicts with decision of Supreme Court in *United States* v. *Cartwright*, 411 U.S. 546, 93 S.Ct. 1713, as well as with decision of another Tenth Circuit panel in *Reardon* v. *United States*, 491 F.2d 822, which latter case holds that "The Commissioner cannot promulgate regulations which impose a tax on the taxpayers which has not been imposed by legislative command."

b. Tenth Circuit panel's decision on main issue is clearly erroneous and conflicts with decision of Supreme Court in *Bulova Watch Co.* v. *United States*, 365 U.S. 753, 81 S.Ct. 864, citing with approval rule noted in *Ginsberg & Sons* v. *Popkin*, 285 U.S. 204, 52 S.Ct. 322, that: "General language of a statutory provision, although broad enough to include it will not be held to apply to a matter specifically dealt with in another part of the same enactment. United States v. Chase, 135 U.S. 255, * * *."

c. Tenth Circuit panel's decision conflicts with plain, unequivocal and certain pattern and language of Section 951(c) and 951(d) IRC 1954, specifically Section 951(d), which read in clear and precise language seriatim:

> "(c) Coordination With Election of a Foreign Investment Company to Distribute Income.—A United

States Shareholder who, for his taxable year, is a qualified shareholder (within the meaning of Section 1247(c)) of a foreign investment company with respect to which an election under Section 1247 is in effect shall not be required to include in gross income, for such taxable year, any amount under subsection (a) with respect to such company."

"(d) Coordination With Foreign Personal Holding Company Provisions. A United States shareholder who, for his taxable year, is subject to tax under section 551(b) (relating to foreign personal holding company income included in gross income of United States shareholders) on income of a controlled foreign corporation shall not be required to include in gross income, for such taxable year, any amount under subsection (a) with respect to such company."

d. Tenth Circuit panel's decision on the main issue conflicts with holding of majority opinion of the *16 Judges* of United States Tax Court (*13 judges agreeing* with the majority opinion, *3 judges dissenting*), in carefully reasoned opinion of Judge Forrester, speaking for majority, in which, regarding contentions of Commissioner which served as basis of panel's decision, he stated at l.c. 504: "However, *there is no more persuasive evidence of the statute's purpose than the words by which Congress undertook to give expression to its wishes,* and here examination of the legislative history does not require a different interpretation of these words. See *United States* v. *Amer. Trucking Ass'ns,* 310 U.S. 534 (1940). *If for any reason the language of the statute should be changed, it is the responsibility of Congress, and not the prerogative of this Court, to effect such change.*" (Italics supplied)

e. Tenth Circuit panel's decision conflicts with established rule of law concerning *standards of interpreta-*

tion of Federal income tax statutes noted in *International Trading Company* v. *Comm'r*, 484 F.2d 707 (USCA-7—decided July 24, 1973—no cert. by gov't), holding a Treasury Regulation of no viable application, at l.c. 713, as follows:

> "However much the statute, in operation, may offend the Commissioner's sense of symmetry and propriety, we cannot say that the results it causes are either absurd or unintended by Congress. Courts have no power (just as the Commissioner has no power in his capacity as an administrative official) 'to rewrite legislative enactments to give effect to' their 'ideas of policy and fitness or the desirability of symmetry in statutes,' United States v. Shirah, 4 Cir., 253 F.2d 798, 800 (1958). The powers of repeal and amendment are uniquely legislative in their nature."

f. Tenth Circuit panel's decision conflicts with decisions in *Busse* v. *Comm'r*, 479 F.2d 1147 (USCA-7); *Brooks* v. *United States*, 473 F.2d 829 (USCA-6); *H. Wetter Manufacturing Company* v. *U. S.*, 458 F.2d 1033 (USCA-6): "We may not, under guise of construction, find a Congressional intent that is contrary to the clear language employed by it."; *General Electric Company* v. *Burton*, 372 F.2d 108 (USCA-6) stating rule to be, based on *Arkansas-Oklahoma Gas Co.* v. *Comm'r*, 201 F.2d 98 (USCA-8): "The Commissioner has no more power to add to the Act what he thinks Congress may have overlooked than he has to supply what Congress has deliberately omitted."; *Manhattan General Equipment Company* v. *Comm'r*, 297 U.S. 129, 56 S.Ct. 397: "The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law—for no such power can be delegated by Congress—but the power to adopt regulations to carry into effect the will of Congress expressed by statute. A regulation which does

not do this but operates to create a rule out of harmony with the statute is a mere *nullity.*"; *Koshland* v. *Helvering,* 298 U.S. 441, 56 S.Ct. 767: "But where, as in this case, the provisions of the act are unambiguous, and its directions specific, there is no power to amend it by regulation." (Emphasis added)

g. Tenth Circuit panel's decision conflicts with a prior decision of Tenth Circuit Court of Appeals in *Comm'r* v. *Zongker,* 334 F.2d 44 (USCA-10), *following* decision in *Comm'r* v. *Kelley,* 293 F.2d 904 (USCA-5), l.c. 912, stating: "Courts are not creatures of grammars or dictionaries. *Neither are they free to ignore common usage and dictionary tested meaning.*—especially in the field of tax legislation where the necessities of the subject require technically exact language and certainty of meaning." (Emphasis added)

h. Tenth Circuit panel's decision fails to *give serious* and in depth consideration to legislative history of act in question, *as was done by Tax Court in its opinion below—see footnote 13 at page 503 of 59 TC 490,* where Tax Court states:

> "It is significant that Congress knew that the operation of subpart F alone might have the effect of taxing greater amounts than would the operations of the foreign personal holding company provisions alone. Thus, the House had recognized that its version of subpart F might establish 'stricter income tests' than the foreign personal holding company provisions. H. Rept. No. 1447, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 405, 435. As a consequence it concluded that the foreign personal holding company provisions should have been modified to conform to subpart F. and wrote into H.R. 10650 at least two basic modifications of those provisions. H. Rept. No. 1447, 87th Cong., 2d Sess.

(1962), 1962-3 C.B. 405, 435-436. However, for reasons suggested at the Senate hearings on H.R. 10650, the Senate eliminated these modifications and the House eventually accepted the Senate's action. Conf. Rept. No. 2508, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 1129, 1147; see Hearings on H.R. 10650 before the Senate Committee on Finance, 87th Cong., 2d Sess., part 2, pp. 561-562; part 7, pp. 3174-3176, 3282-3283; part 11, pp. 4893-4894 (1962)."

i. Further, panel's decision, in holding that Section 951(d) IRC 1954 did not control so as to invalidate, as held by majority of 13 judges of the Tax Court, Regulation attempting to interpret Section 951(d), gave priority to an *unclear regulation* over a *plain, clearly worded and unambiguous statute*, i.e. Section 951(d). This is noted in panel's decision where it is stated: "The regulation is not particularly clear on the problem at hand, but the examples do make the distinction above described." Further, panel's decision fails to give consideration to pattern of legislation as outlined in detail in *cross appellants' brief* in Tenth Circuit, which pattern shows that wording of statute, Section 951(d), corresponds to legislative intent of combined Senate and House, as agreed to in conference. Panel's decision overlooks entirely pattern of legislation enacted in companion provisions of Sections 13 and 16 (House Version) and Sections 12 and 15 of Senate version, which have become Sections 951 et sequitur and Section 1248 IRC 1954, which provisions are companion sections in same legislation introduced into Congress to achieve purpose sought by legislation. (See House Report No. 1447, 87th Congress, Second Session, and Senate Report No. 1881, (same session) to accompany H.R. 10650, 1962 CB 3, pages 405 et seq., and 703 et seq.).

j. Further, Regulation Sec. 1.951.3, relied upon by the panel, is in itself, in conflict with the thrust of Regulation Sec. 1.951-2, interpreting Section 951(c), which is the companion coordinating section along with Section 951(d) IRC 1954. Said Regulation Sec. 1.951-2 reads:

> "A United States shareholder who for his taxable year is a qualified shareholder (within the meaning of section 1247(c)) of a foreign investment company with respect to which an election under section 1247(a) and the regulations thereunder is in effect for the taxable year of such company which ends with or within such taxable year of such shareholder shall not be required to include any amount in his gross income for his taxable year under paragraph (a) of Sec. 1.951-1 with respect to such company for that taxable year of such company."

k. Panel's decision further is in conflict with legislative history of act when it concludes that pre-1963 earnings of Oil Services could be included as a measuring stick for taxable income under Section 951 et sequitur IRC 1954 (see *House Ways and Means Committee Report #1447 to accompany* H.R. 10650 (1962 C.B. 3, pp. 405, 461-468), noting purpose of bill and interrelationship of Section 13 (now Section 12) relating to Subpart F and Section 16 (now Section 15), being Section 1248 IRC 1954, which reads in part as below at l.c. 467 of 1962 C.B. 3):

> "Since the concept here is merely to tax to the U.S. shareholder the *earnings and profits of the corporations since the end of 1962*, the investments in nonqualified property taken into account are only those which are in excess of earnings and profits accumulated in taxable years beginning after December 31, 1962. With respect to any year, therefore, the

increase in nonqualified property is the excess of property of this type at the end of the current taxable year over property of this type as of the end of the prior taxable year."

"Since *it is not intended* that this provision *in any sense be retroactive,* only nonqualified property acquired after December 31, 1962, is taken into account * * *." (Emphasis added)

l. Tenth Circuit panel's decision takes inconsistent positions in that said decision finds that statute, Section 951(a) makes no stated provision for exclusion of pre-1963 earnings in computing measuring stick for taxable income under Section 951 et sequitur IRC 1954, *while at same time failing to follow plainly stated requirements of Section 951(d) IRC 1954,* a companion section to Section 951(c), which plainly and unequivocally holds that, under factual circumstances involved in this proceeding, where a United States shareholder is subject to tax under Section 551(b) IRC 1954 as shareholder in foreign personal holding company, that shareholder shall not be required to include in income for such tax year "*any amount* under subsection (a) with respect to such company", with *subsection (a) covering investments in U. S. property,* and this despite fact that legislative history of act shows an intent to exclude pre-1963 earnings in applying statute.

m. Tenth Circuit panel's decision in sustaining constitutionality of Sections 951(a)(1)(B) and 956(a)(1),(2) against attack made on ground that said sections are invalid under Article I, Section 2, Clause 3, and Section 9, Clause 4 of the U. S. Constitution fails to give due weight to effect of Supreme Court decisions in *Eisner* v. *Macomber,* 252 U.S. 189, 40 S.Ct. 189 and *Pollock* v. *Farmers Loan and Trust Company,* 157 U.S. 429, 15 S.Ct. 673, which have been held

to be of continuing validity in *Comm'r* v. *O'Bear-Nester Glass Co.*, 217 F.2d 56 (USCA-7) and *Kohl* v. *U. S.*, 226 F.2d 381 (USCA-7), with distinction *between tax on income and tax imposed on ownership of property* being noted in Mertens, Law of Federal Income Taxation, Volume 1, paragraph 4.08, page 10. Tax under Section 951(a) is clearly not a transaction tax since the shareholders are not shown to have engaged in transactions under stipulated facts involved. The panel's decision further fails to give due weight to the decisions in *Moline Properties* v. *Comm'r*, 319 U.S. 436, 63 S.Ct. 1132, and *United States* v. *Whipple*, 373 U.S. 193, 83 S.Ct. 1168, which *latter case* holds that trade or business of a corporation is *not* that of its chief stockholder.

n. Panel's decision in failing to sustain attack on constitutionality of statute in question fails to give due weight or consideration to decisions in *Hoeper* v. *Tax Commission*, 284 U.S. 206, 52 S.Ct. 120, and *Heiner* v. *Donnan*, 285 U.S. 312, 52 S.Ct. 358, which in effect support proposition that an absolute presumption of existence of income is a *violation of the Fifth Amendment*. This point is particularly relevant here, where neither stipulation filed in Tax Court, nor findings of Tax Court indicated that taxpayers received any income under Section 951(a) out of Oil Services, Inc. with which to pay asserted liabilities which exceed a quarter of a million dollars, including interest. This violates fundamental principle, namely: "That is taxation which compels one to pay for the support of the government from his own gains and *his own property.*" (*U. S.* v. *Railroad Company*, 17 Wall. 322, 326). (Italics supplied)

Pertaining to Year 1963
(A portion of points related to 1964-1967 also affect 1963)

o. Further, with reference to year 1963, panel's decision, in holding that three year statute of limitations set

out in Section 6501(a) IRC 1954 did not control, failed to give due weight to fact that taxpayers filed *with their 1963 return very form 2952* required to be filed under provisions of Regulation Sec. 1.6038-2(a) and (i) 26 CFR, which form disclosed existence of Oil Services, Inc., stock ownership, income of the corporation, and a balance sheet of the corporation, showing holding of notes and accounts receivable, and stock investments, plus statement on page 2 of form 2952 that oil services had made loans to U. S. person filing return of $15,975 and to any corporation controlled by U. S. person filing return of $76,808.88 (later essentially repaid). It thus gave to Commissioner the "clue" that further audit might be required, as referred to in *Colony, Inc.* v. *Commissioner,* 357 U.S. 28, 78 S.Ct. 1033, and *Benderoff* v. *U. S.,* 398 F.2d 132 (USCA-8), which later case holds that: "The proper test thus appears to be whether the return provides a clue as to the omitted item." *Such clue was given* in filing of *form required by Internal Revenue Service* attached to return.

In essence, and with all due deference and respect to the panel, as distinguished from the full Court of the Tenth Circuit Court of Appeals which handed down the decision on April 22, 1974 (petition for rehearing en banc being denied), it is submitted that failure to give appropriate weight to contrary authorities and legislative history of companion Sections 951 et sequitur, and Section 1248 and particularly to give weight to carefully reasoned opinion of Judge Forrester, speaking for *majority of 13 judges* of Tax Court, and his analysis of legislative history of companion sections (see footnote 13 of his decision), render decision of panel erroneous as a *matter of law* with reference to application of Section 951(d) to taxpayers' case, and with reference to issue of whether pre-1963 earnings are to be considered in applying statute, and as a *matter*

of fact, in determining whether a sufficient "clue" was given to Commissioner by filing the statutory and regulation mandated form 2952 with 1963 return disclosing existence of Oil Services, its stock ownership, 1963 income and balance sheet disclosing investments in various kinds of accounts and notes receivable and stock, and transactions on page 2 of form 2952 with the U. S. person and corporation controlled by U. S. person, so as to raise bar of three year statute of limitations.

It is further contended that no really serious explanation has been given by Tenth Circuit panel as to why provisions of Section 951(a) IRC 1954, in application to taxpayers of a foreign corporation, who do not in fact receive income from that corporation, are not a violation of direct tax provisions of U. S. Constitution and the Fifth Amendment thereto prohibiting taking of property without due process of law, i.e., by taxing income which the said shareholders did not receive under stipulated facts and findings of Tax Court. It does not suffice to call the tax a transaction tax when the shareholders, as distinguished from corporation, engage in no transactions.

Ultimate Reason for Granting Writ

In essence, this is a case, which if the decision of panel of Tenth Circuit Court of Appeals (as distinguished from full Court) is left to stand, will cause, according to information furnished to taxpayers' counsel, the widow involved herein to be penniless and dependent. In addition, decision below of the panel of the Tenth Circuit Court of Appeals is erroneous as a matter of law, and an usurpation of the right of the Congress to legislate in the manner in which it sees fit, an invasion by the judiciary of the functions of the legislative body. Such results should not be considered as acceptable by this Court, without at least a

full hearing, by the full Court on grant of certiorari, particularly in the light of conflict between panel's decision in the Tenth Circuit and the carefully reasoned decision of Judge Forrester, speaking for a majority of 13 of the 16 members of the United States Tax Court, in the decision of the Tax Court found in Volume 59 TC 490, as well as in conflict with a contemporaneous decision of another panel of the Tenth Circuit Court of Appeals on the weight to be given a regulation of the Commissioner, found in *Reardon* v. *U. S.*, 491 F.2d 822 (USCA-10), decided February 8, 1974.

CONCLUSION

WHEREFORE, petitioners move this Court to grant Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit as requested.

Respectfully submitted,

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APPENDIX

APPENDIX A

59 T. C. No. 48

UNITED STATES TAX COURT

ESTATE OF LEONARD E. WHITLOCK, DECEASED, GEORGIA M. WHITLOCK, EXECUTRIX, AND GEORGIA M. WHITLOCK, Petitioners *v.* COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 386-70. Filed December 29, 1972.

For 1963 Oil Services was a controlled foreign corporation and for 1964, 1965, and 1967, it was both a controlled foreign corporation and a foreign personal holding company. For each of these years Oil Services had an increase in its earnings invested in United States property as defined in sec. 956. Petitioners were Oil Services' only shareholders and were its only United States shareholders. For 1964, 1965, and 1967, they were subject to tax under sec. 551(b) on Oil Services' income.

Held: For 1964, 1965, and 1967, petitioners were not required to include in their gross income any part of Oil Services' increase in earnings invested in United States property for those years. Sec. 951(d). Sec. 1.951-3, Income Tax Regs., insofar as it runs contrary to this conclusion, is invalid.

Held, further, for 1963 petitioners were required to include such earnings for that year in their gross income. Sec. 951(a)(1)(B). There is no constitutional bar to that inclusion.

Held, further, for 1963, since petitioners omitted gross income in excess of 25 percent of the amount of gross income stated in their return and since they did not provide adequate disclosure of such omitted items, respondent is entitled to the six-year statute of limitations of sec. 6501(e)(1)(A).

R. Eugene McGannon and *Philip J. Erbacher,* for the petitioners.

Edward G. Lavery, for the respondent.

OPINION

FORRESTER, *Judge*: Respondent determined deficiencies in petitioners' income tax of $25,106.64, $1,552.76, $17,328.88, and $141,985.23 for the taxable years 1963, 1964, 1965, and 1967, respectively. The main issue we must decide is whether petitioners, who, for the taxable years 1964, 1965, and 1967, were United States shareholders subject to tax under section 551(b)[1] on income of a controlled foreign corporation, were required to include in gross income for such taxable years any amounts under section 951(a) with respect to such corporation. In addition, we must pass upon the constitutionality of the tax imposed on an amount equal to petitioners' pro rata share of their controlled foreign corporation's increase in earnings invested in United States property. Finally, we must decide whether respondent's determination of a deficiency for the taxable year 1963 was barred by the statute of limitations.

All of the facts have been stipulated and are so found. The stipulation and all exhibits attached thereto are incorporated herein by this reference.

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1. Unless otherwise specified all statutory references are to the Internal Revenue Code of 1954.

During the years involved in this proceeding Leonard E. Whitlock and Georgia M. Whitlock were husband and wife residing in Stafford, Kansas. Leonard E. Whitlock died on October 11, 1967, while a resident of Stafford, Kansas. On January 5, 1968, Georgia M. Whitlock, his widow, was duly appointed executrix of the estate of Leonard E. Whitlock by the probate court of Stafford County, Kansas. At all times since then she has acted in that capacity, and is the duly qualified and still acting executrix of the estate of Leonard E. Whitlock. At the time she filed the petition in this case, she resided in Stafford, Kansas. For convenience, we shall hereinafter sometimes refer to Leonard E. Whitlock and Georgia M. Whitlock as Leonard and Georgia, or, simply, petitioners.

Petitioners filed joint Federal income tax returns for the calendar years 1963 and 1964 with the district director of internal revenue in Wichita, Kansas, and filed a joint Federal income tax return for the calendar year 1965 with the district director of internal revenue in Dallas, Texas. After Leonard's death, Georgia filed a joint Federal income tax return for the taxable year 1967 for Leonard E. Whitlock, deceased, and Georgia M. Whitlock with the district director of internal revenue in Wichita, Kansas. All of these returns were filed on the cash basis.

During the years 1963 through 1967, Leonard (until the time of his death) and Georgia were both United States citizens.

Whitlock Oil Services, Incorporated (hereinafter referred to as Oil Services) was a foreign corporation incorporated under the laws of the Republic of Panama. For each of its taxable years 1963 through 1967, Oil Services' taxable year was the calendar year.

During 1963 and 1964, petitioners, as joint tenants with right of survivorship, owned all of Oil Services' stock. During the first half of 1965 Leonard relinquished all of his interest in Oil Services' stock, and thereafter, during the last half of 1965, all of 1966, and all of 1967, Georgia held all of Oil Services' stock.

At a point during the years 1963 through 1967, Oil Services acquired and, at the end of each year noted, held United States property (as defined in section 956(b)) having adjusted bases as follows:

	1963	1964	1965	1966	1967
Obligations of United States Persons - Accounts Receivable					
Whitlock & Associates, Inc.		$ 5,125.00			
L. E. Whitlock		21,211.52			
L. E. Whitlock Truck Services, Inc.	$ 1,153.00	1,153.00	$ 1,153.00	$ 1,153.00	$ 1,153.00
B. I. Whitlock		1,000.00	1,000.00	1,000.00	1,000.00
Cotina Corporation		317.50	8,650.57	8,650.57	8,650.57
International Veneer			11,489.24	11,489.24	11,489.24
W. M. Baier, Jr.				2,000.00	2,000.00
Dinastatco					95,135.85
AWB Mfg. Co.					131,547.93
Obligations of United States Persons - Notes Receivable					
L. E. Whitlock			15,422.51	15,422.51	15,422.51
Henry Zipf	2,500.00	2,500.00			
Whitlock & Associates, Inc.			188,319.43	188,319.43	186,816.98
Stock of a Domestic Corporation					
Cotina Corporation	10,000.00	10,000.00			
Totals	$13,653.00	$41,307.02*	$226,034.75	$228,034.75	$453,216.08**

*Of this amount, petitioners, as shown on a schedule attached to their 1964 return, actually included $16,323.41 in their 1964 gross income.

**Of this amount, petitioners, as shown on a schedule attached to their 1967 return, actually included $548.49 in their 1967 gross income.

At the end of each of the years 1963 through 1967, Oil Services' retained earnings and profits (computed with reference to section 1.956-1(b), Income Tax Regs.) were sufficient in amount so that they did not limit the amounts, if any, otherwise includable in petitioners' gross income under section 951(a), if such section is applicable. The aforesaid earnings and profits were accumulated prior to 1963, except to the extent of the following amounts:

1. Earnings and profits accumulated in 1963 $26,459.99
2. Earnings and profits representing undistributed foreign personal holding company income and excludable from earnings and profits under sec. 1.956-1(b), Income Tax Regs., for the year:
   - (a) 1964 6,865.08
   - (b) 1965 17,997.49
   - (c) 1966 11,024.65
   - (d) 1967 14,633.07

Prior to 1964, Oil Services had never been a foreign personal holding company within the meaning of section 552, nor had its shareholders included in gross income any amount under section 551 with respect to that corporation. However, during the years 1964 through 1967, Oil Services was a foreign personal holding company as defined in section 552.

For the periods listed below Oil Services derived gross income as follows:

Gross Income	January 1, 1964—November 30, 1964	December 1, 1964—December 31, 1965	January 1, 1967—December 31, 1967
Interest	$6,865.08	$17,997.49	$18,501.55
Miscellaneous	425.00		

In computing Oil Services' foreign personal holding company income for 1967 petitioners deducted $4,786.04 under section 954(b)(5), as deductions allocable to the $18,501.55 of interest income for that year. Of the $4,786.04 deducted $3,868.48 represented "Federal income tax."

For the years 1964 through 1967 Oil Services had undistributed foreign personal holding company income which consisted entirely of interest of a type not described in section 954(c)(3) or 954(c)(4), and which was includable in petitioners' gross income under section 551 as follows:

Year	Undistributed foreign personal holding company income includable in petitioners' gross income under section 551
1964	$ 6,865.08
1965	17,997.49
1966	11,024.65
1967	14,633.07

In their 1967 Federal income tax return petitioners included $13,715.51 in gross income under section 551.

If sections 951 and 956(a) may be constitutionally applied to this case (which application petitioners deny), the following amounts would have been included in petitioners' gross income for the taxable year 1963 as their pro rata share of Oil Services' increase in earnings invested in United States property:

Account receivable from L. E. Whitlock Truck Services, Inc.	$ 1,153
Note receivable from Henry Zipf	2,500
Cotina Corporation stock	10,000
	$13,653
Less: Current and previously taxed Sub-part F income	-0-
Total amount includable in petitioners' gross income	$13,653

The aforesaid amount, which petitioners omitted from gross income on their 1963 joint Federal income tax return, is in excess of 25 percent of the amount of gross income stated in that return.

Pursuant to section 6501(c)(4) petitioners (or their duly authorized representatives) and respondent timely consented in writing to extend the period of limitations for the years 1964 and 1965 to June 30, 1970. The parties did not enter into such a consent for 1963. Petitioners filed their 1963 joint Federal income tax return on or about April 15, 1964. The statutory notice of deficiency in this case was sent to petitioners by certified mail on December 30, 1969.

Attached to petitioners 1963 joint income tax return was an "Information Return with Respect to Controlled Foreign Corporations" (Form 2952, Rev. Dec. 1963). Accompanying that information return was Oil Services' balance sheet as of December 31, 1963. The assets listed on the balance sheet were as follows:

Cash on hand and in banks	$163,751.59
Notes receivable	47,077.49
Accounts receivable	181,924.88
Accrued interest receivable	17,659.84
Prepaid insurance	924.28
Investment in common stocks	257,500.00
Automobile (net of depreciation)	2,777.14
Airplane (net of depreciation)	26,085.59
	$697,700.81

There was no indication on the information return or on any other statement attached to petitioners' 1963 joint income tax return that any of the above-listed assets constituted obligations of United States persons or stock of a domestic corporation, nor was there any listing of Oil Services' assets as of the beginning of 1963.

In general the statutory framework of the Internal Revenue Code of 1954 does not reach out to tax the foreign source income of a foreign corporation. See Bittker and Ebb, United States Taxation of Foreign Income and Foreign Persons 338 (1968). However, where such a corporation is controlled by United States interests, the corporation's United States shareholders may, under the statute, be obliged to include all or part of the corporation's income and earnings as their own. The foreign personal holding company provisions of sections 551 through 558 and the controlled foreign corporation provisions of sections 951 through 964 (hereinafter referred to as subpart F) define

two areas where a foreign corporation's income may be attributed to its United States shareholders.[2]

1. Taxable Years 1964, 1965, and 1967

The principal question in this case involves the interrelation of the complex foreign personal holding company provisions with the even more complex provisions of subpart F.

For the years 1964, 1965, and 1967, Oil Services was both a foreign personal holding company as that term is defined in section 552(a)[3] and a controlled foreign corpora-

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2. It should be emphasized that in both subpart F and the foreign personal holding company provisions United States shareholders are taxed on their proportionate shares of various items. Since in the present case one or both of petitioners owned all of Oil Services' stock for the relevant years here, it is unnecessary for our discussion to speak in terms of proportionate shares.

3. SEC. 552 DEFINITION OF FOREIGN PERSONAL HOLDING COMPANY.

(a) General Rule.—For purposes of this subtitle, the term "foreign personal holding company" means any foreign corporation if—

(1) Gross income requirement.—At least 60 percent of its gross income (as defined in section 555(a)) for the taxable year is foreign personal holding company income as defined in section 553; but if the corporation is a foreign personal holding company with respect to any taxable year ending after August 26, 1937, then, for each subsequent taxable year, the minimum percentage shall be 50 percent in lieu of 60 percent, until a taxable year during the whole of which the stock ownership required by paragraph (2) does not exist, or until the expiration of three consecutive taxable years in each of which less than 50 percent of the gross income is foreign personal holding company income. For purposes of this paragraph, there shall be included in the gross income the amount includible therein as a dividend by reason of the application of section 555(c)(2); and

(2) Stock ownership requirement.—At any time during the taxable year more than 50 percent in value of its outstanding stock is owned, directly or indirectly, by or for not more than five individuals who are citizens or residents of the United States, hereinafter called "United States group".

tion as that term is defined in section 957(a).[4] Oil Services' only shareholders, and, more particularly, its only United States shareholders, during 1964 and the first half of 1965 were petitioners Leonard and Georgia. During the remainder of 1965 and on through 1967 Oil Services' sole shareholder and only United States shareholder was petitioner Georgia.[5]

Section 551(a) provides that the undistributed foreign personal holding company income of a foreign personal holding company shall be included in the gross income of the foreign personal holding company's United States shareholders in the manner and to the extent set forth in sections 551 through 558. A foreign personal holding company's undistributed foreign personal holding company income is defined as the foreign personal holding company's taxable income adjusted in the manner provided in section 556(b), minus the dividends paid deduction as defined in section 561. Sec. 556(a).

For the years 1964, 1965, and 1967, Oil Services' undistributed foreign personal holding company income (which

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4. SEC. 957. CONTROLLED FOREIGN CORPORATIONS: UNITED STATES PERSONS.

(a) General Rule.—For purposes of this subpart, the term "controlled foreign corporation" means any foreign corporation of which more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b), by United States shareholders on any day during the taxable year of such foreign corporation.

5. The definition of United States shareholder under the foreign personal holding company provisions differs from the definition of that term under subpart F. Compare sec. 551(a) with sec. 951(b). However, in the instant case, for the purposes of either the foreign personal holding company provisions or subpart F, both Leonard and Georgia were United States shareholders of Oil Services whenever they were shareholders of Oil Services.

consisted entirely of interest income) was almost equal to its foreign personal holding company income.[6] Accordingly under section 551(b) petitioners were required to include in their gross income, as a dividend, the amount they would have received as a dividend if on the last day of each of the years 1964, 1965, and 1967, Oil Services had distributed, and petitioners had received, all of Oil Services' undistributed foreign personal holding company income. Both parties agree that for petitioners' taxable years 1964, 1965, and 1967, petitioners were thus subject to tax under section 551(b).

Turning to section 951(a) we find that as pertinent in the instant case, every United States shareholder of a controlled foreign corporation—

> shall include in his gross income, for his taxable year in which or with which such taxable year of the corporation ends—
>
> (A) the sum of—
>
> (i) except as provided in section 963, his pro rata share (determined under paragraph (2)) of the corporation's subpart F income for such year, and

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6. Oil Services' only income during the taxable years 1964, 1965, and 1967, was derived from interest except for $425 of "miscellaneous" income in 1964. The parties have not explained whether they treated this "miscellaneous" income as foreign personal holding company income, nor have they explained why they did not treat such income as undistributed foreign personal holding company income. Also, it should be noted that for 1967 the difference between Oil Services' interest income of $18,501.55 and its undistributed foreign personal holding company income of $14,633.07 is apparently due to the reduction of the interest income by certain deductions properly allocable to it under sec. 954(b)(5). While on their 1967 return petitioners had originally deducted $4,786.04, the inference from the stipulation is that the parties here agreed that only $3,868.48 representing "Federal income tax" is properly allocable to that interest income.

(ii) his pro rata share (determined under section 955(a)(3)) of the corporation's previously excluded subpart F income withdrawn from investment in less developed countries for such year; and

(B) his pro rata share (determined under section 956(a)(2)) of the corporation's increase in earnings invested in United States property for such year (but only to the extent not excluded from gross income under section 959(a)(2)).

Subpart F income is defined as the sum of income derived from the insurance of United States risks, and foreign base company income. Sec. 952(a). Foreign base company income is further defined as the sum of foreign personal holding company income, foreign base company sales income, and foreign base company services income. Sec. 954(a).

For 1964, 1965, and 1967, Oil Services had no previously excluded subpart F income withdrawn from investment in less developed countries, but it did have both subpart F income and an increase in earnings invested in United States property for each of such years. And almost all, if not all, of its subpart F income for 1964, 1965, and 1967, was foreign personal holding company income as defined in section 954.[7] This foreign personal holding company income as defined in section 954 consisted of the very same income which constituted foreign personal holding company income as defined under section 553 of the foreign personal holding

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7. The parties have not explained whether they have treated Oil Services' "miscellaneous" income of $425 for the taxable year as subpart F income. See fn. 6, *supra*.

company provisions and which would have been includable in petitioners' gross income under section 551(b).[8]

Applying simultaneously the dictates of sections 551(b) and 951(a), petitioners might have been obliged to include the very same interest income twice in their own gross income.

Fortunately for United States shareholders of corporations simultaneously qualifying as foreign personal holding companies and controlled foreign corporations, subpart F contains a saving provision to protect against the possibility of such double taxation. That provision, section 951(d), provides as follows:

> (d) Coordination with Foreign Personal Holding Company Provisions.—A United States shareholder who, for his taxable year, is subject to tax under section 551(b) (relating to foreign personal holding company income included in gross income of United States shareholders) on income of a controlled foreign corporation shall not be required to include in gross income, for such taxable year, *any amount* under subsection (a) with respect to such company. [Emphasis supplied.]

Were it not for section 951(d), petitioners under section 951(a) would have had to include in their gross income for their taxable years 1964, 1965, and 1967, the sum of (1)

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8. Note that under sec. 553 foreign personal holding company income has a definition different from the corresponding definition under sec. 954. Thus, sec. 954(c)(1) provides that for the purposes of subpart F foreign personal holding company income means foreign personal holding company income as defined in sec. 553 as further modified and adjusted by the provisions of sec. 954(c)(2), (3), and (4). However, in the present case it appears that whether determined under the foreign personal holding company provisions or under subpart F, foreign personal holding company income would come to the same amount.

Oil Services' foreign personal holding company income (as determined under section 954(c) via sections 951(a)(1)(A)(i), 951(a)(2), 952(a)(2), and 954(a)(1)) *and* (2) Oil Services' increase in earnings invested in United States property (as determined under section 956 via sections 951(a)(1)(B) and 951(a)(4)). The parties agree that because of section 951(d), petitioners need not include Oil Services' foreign personal holding company income in their gross income under section 951(a). However, despite section 951(d), respondent argues that petitioners must include Oil Services' increase in earnings invested in United States property in their gross income under section 951(a)(1)(B).

If we were faced only with the provisions of the statute, we would have little trouble in rejecting respondent's argument and adopting the straightforward reading of section 951(d) urged upon us by petitioners. Since for Leonard's taxable years 1964 and 1965 and for Georgia's taxable years 1964, 1965, and 1967, each was a "United States shareholder who, for his taxable year, is subject to tax under section 551(b) * * * on income of a controlled foreign corporation," it would apparently immediately follow that they "shall not be required to include in gross income, for such taxable year, *any amount* under subsection (a) with respect to such company." (Emphasis supplied.)

Unfortunately our judicial task becomes complicated because respondent finds direct support for his position in section 1.951-3, Income Tax Regs., which provides in pertinent part as follows:

> A United States shareholder (as defined in section 951(b)) who is required under section 551(b) to include in his gross income for his taxable year his share of the undistributed foreign personal holding company income *for the taxable year* of a foreign personal holding company (as defined in section 552) which for

> that taxable year is a controlled foreign corporation (as defined in section 957) shall not be required to include in his gross income for his taxable year under section 951(a) and paragraph (a) of section 1.951-1 any amount attributable to the earnings and profits of such corporation *for that taxable year* of such corporation. * * * [Emphasis supplied.]

This regulation indirectly implies that a United States shareholder who, for his taxable year, is subject to tax under section 551(b) on income of a controlled foreign corporation might be required to include in his gross income for that year amounts attributable to the corporation's earnings and profits for one of the corporation's other taxable years. That implication is actually spelled out in example 5 of the regulation where it is held that if a corporation is both a foreign personal holding company and a controlled foreign corporation for its taxable year, its sole United States shareholder must include in his gross income for his corresponding taxable year not only the corporation's undistributed foreign personal holding company income as required under section 551(b), but also its increase in earnings invested in United States property for that year.[9]

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9. Example (4). (a) A, a United States shareholder, owns 100 percent of the only class of stock of controlled foreign corporation P, organized on January 1, 1963. Both A and P Corporation use the calendar year as a taxable year. During 1963, 1964, and 1965, P Corporation is not a foreign personal holding company as defined in section 552(a); in each of such years, P Corporation derives dividend income of $10,000 which constitutes foreign personal holding company income (within the meaning of section 1.954-2) but under paragraph (b)(1) of section 1.954-1 excludes such amounts from foreign base company income as dividends received from, and reinvested in, qualified investments in less developed countries. Corporation P's earnings and profits accumulated for 1963, 1964, 1965 and determined under paragraph (b)(2) of section 1.955-1 are $40,000. For 1966, P Corporation is a foreign personal holding company, has predistribution earnings and profits of $10,000, derives $10,000 of income which is both foreign personal holding company income within the

(Continued on following page)

Petitioners ask that we invalidate this regulation. We find their request compelling, and hold that insofar as section 1.951-3, Income Tax Regs., requires a United States shareholder, who for his taxable year is subject to tax under section 551(b) on income of a controlled foreign corporation, to include in gross income for such taxable year any amount under section 951(a)(1)(B) with respect to such controlled foreign corporation, it is invalid.

In invalidating this regulation we have borne in mind the general principles that regulations must be upheld unless they are unreasonable or plainly inconsistent with the

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Footnote continued—

meaning of section 553 and subpart F income within the meaning of section 952, distributes $8,000 to A, and has undistributed foreign personal holding company income of $2,000 within the meaning of section 556. In addition, for 1966 P Corporation has a withdrawal (determined under section 955(a) but without regard to its earnings and profits for such year) of $25,000 of previously excluded subpart F income from investment in less developed countries. A is required under section 551(b) to include in his gross income for 1966 as a dividend the $2,000 undistributed foreign personal holding company income. The $8,000 distribution is includible in A's gross income for 1966 under sections 61(a)(7) and 301 as a distribution to which section 316(a)(2) applies. Coporation P's $25,000 withdrawal of previously excluded subpart F income from investment in less developed countries is includible in A's gross income for 1966 under section 951(a)(1)(A)(ii) and paragraph (a)(2) of section 1.951-1.

* * *

Example (5). (a) The facts are the same as in paragraph (a) of example (4), except that, instead of having a $25,000 decrease in qualified investments in less developed countries for 1966, P Corporation invests $20,000 in tangible property (not described in section 956(b)(2)) located in the United States and such investment constitutes an increase (determined under section 956(a) but without regard to the earnings and profits of P Corporation for 1966) in earnings invested in United States property. Corporation P's earnings and profits accumulated for 1963, 1964, and 1965 and determined under paragraph (b)(1) of section 1.956-1 are $22,000. The result is the same as in paragraph (a) of example (4) except that instead of including the $25,000 withdrawal, A must include $20,000 in his gross income for 1966 under section 951(a)(1)(B) and paragraph (a)(3) of section 1.951-1 as an investment of earnings in United States property.

statute and should not be overruled except for weighty reasons, *Commissioner* v. *South Texas Co.*, 333 U.S. 496, 501 (1948), that insofar as a regulation is not in conflict with express statutory provisions, it has the force and effect of law, *Maryland Casualty Co.* v. *United States*, 251 U.S. 342, 349 (1920), and that where a statute uses "ambiguous terms, or is of doubtful construction, a clarifying regulation or one indicating the method of its application to specific cases not only is permissible but is to be given great weight by the courts." *Koshland* v. *Helvering*, 298 U.S. 441, 446 (1936). But we are also well aware of the propositions that the statute is the primary authority, and the regulations to the extent they are in conflict with the statute are void, *Boykin* v. *Commissioner*, 260 F.2d 249, 254 (C.A. 8, 1958), modifying 29 T.C. 813 (1958), that a regulation which conflicts with statutory provisions is a mere nullity, *Fabian Tebon, Jr.*, 55 T.C. 410, 413 (1970), and that where the provisions of a statute "are unambiguous, and its directions specific, there is no power to amend it by regulation." *Koshland* v. *Helvering, supra* at 447.

We believe that application of these principles leads to the inevitable conclusion that the regulation in question here is not only inconsistent with the clear and unambiguous language of the statute but would have the effect of departing from and putting aside the statutory mandate. See *Lynch* v. *Tilden Co.*, 265 U.S. 315, 321 (1924).

Respondent has presented numerous arguments to uphold the validity of his regulation. We are persuaded by none of those arguments for we fail to see how section 1.951-3, Income Tax Regs., can reasonably transform the term "any amount under subsection (a)" into the term "any amount under subsection (a) except amounts under subparagraph (a)(1)(B)."

Respondent's principal contention is that petitioners' reading of section 951(d) runs counter not only to the regulations but to the "statutory scheme" itself. Subpart F was first enacted as part of the Revenue Act of 1962, 76 Stat. 960. By reference to certain general language in the Senate Finance Committee report accompanying the bill which eventually became the Revenue Act of 1962, respondent claims that petitioners' construction—

> would thwart the purpose of section 951(a)(1)(B) which was enacted, in general, "* * * to end tax deferral on 'tax haven' operations by U.S. controlled corporations," and, more specifically to insure that foreign corporations' "* * * earnings are not indirectly brought back to the United States in a manner which avoids the U. S. tax * * *" S. Rept. 1881, 87th Cong. (1962), C.B. 1962-3, 785-86.

Even assuming that the existence of a clear "statutory scheme" would be sufficient to allow this Court to rewrite the language of the statute, we are unable to agree with respondent's premise that such a consistent "statutory scheme" exists. While we do not doubt that Congress sought to achieve the general purposes quoted above in the Senate committee report, it appears that subpart F, as finally enacted, embodies numerous exceptions to those general purposes. A review of the events leading to the enactment of subpart F is sufficient to show that respondent's ideal of a "statutory scheme" is elusive indeed.

In 1961, President Kennedy sent a tax revision proposal to Congress. In that proposal the President recognized that, "Profits earned abroad by American firms operating through foreign subsidiaries are, under present tax laws, subject to U. S. tax only when they are returned to the parent company in the form of dividends." Hearings on the President's 1961 Tax Recommendations Before the House

Committee on Ways and Means, 87th Cong., 1st Sess., vol. 1, p. 8 (1961). In order to prevent such tax deferral the President proposed legislation which would have taxed "each year American corporations on their current share of the undistributed profits realized in that year by subsidiary corporations organized in economically advanced countries. This current taxation would also apply to individual shareholders of closely held corporations in those countries." Id. at p. 9.

After lengthy hearings the House decided that the President's recommendations went too far and might have had the effect of placing American-owned business operating abroad at a disadvantage with respect to firms operating in the same areas but not subject to United States tax. H. Rept. No. 1447, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 405, 461-462. Thus, when the House passed H. R. 10650, which eventually became the Revenue Act of 1962, it concentrated primarily on curbing "tax haven" devices and did "not eliminate tax deferral in the case of operating businesses owned by Americans which are located in the economically developed countries of the world." H. Rept. No. 1447, *supra* at 1962-3 C.B. 461-462; S. Rept. No. 1881, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 707, 785. The Senate made further changes which included at least two major "escape valves" and numerous other minor relief provisions. S. Rept. No. 1881, *supra* at 1962-3 C.B. 785-786. Consequently, as eventually enacted subpart F and various related provisions contained many major and minor exceptions to both the President's original proposals and the Congressional "general purposes" upon which respondent places such heavy reliance. See, e.g., secs. 954(b)(3), 954(b)(4), 954(c)(3), 956(b)(2), 962, 963, 970-972. While the President's recommendations may have been founded upon broad theories of tax revision, a quick glance at subpart F will show that Congress legislated in very detailed, tightly organized, and

multi-definitional terms in creating these numerous exceptions. No doubt Congress had important and weighty reasons to carve out these exceptions, and many of these reasons are set forth in the committee reports accompanying H. R. 10650.[10]

But the point to be observed is that the existence of these many exceptions makes it hard to glean from subpart F the precise "statutory scheme" to which respondent alludes. In summary, we are not prepared to say that the purposes and goals of subpart F have been so obviously revealed as to preclude the possibility that Congress intended in certain cases that section 951(d) would provide favorable treatment for the taxpayer.

In any event, if we narrow the scope of our inquiry to an examination of the legislative history leading to the provisions for the coordination of the foreign personal holding company provisions with subpart F, we would find not only that such history fails to reveal any strongly pronounced policy with respect to the rule which is set forth in section 1.951-3, Income Tax Regs., but that there is good evidence that in using the language of section 951(d), Congress fully

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10. In view of the many exceptions engrafted onto H. R. 10650 it is not surprising that certain Senators used rather strong language in describing the gradual erosion of the President's original aims. Thus, Senator Douglas stated that, "under heavy battering from American corporations doing business abroad, the proposed levies based on the earnings of their foreign subsidiaries were progressively softened, although there were some not satisfied even with that, who proposed to eliminate even the emasculated version still remaining." 108 Cong. Rec. 17766 (1962). And Senator Gore remarked that, "It really is a heartbreaking experience to see amendments such as the Committee on Finance has approved, offered at the last minute, to take care of special interests, which create and perpetuate such a loophole for tax dodgers." 108 Cong. Rec. 18189 (1962). See also Supplemental and Minority Views of Senators Paul Douglas and Albert Gore, S. Rept. No. 1881, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 1092, 1120-1128.

intended the result required by a straightforward reading of that language.

To prevent the possibility of taxation of the same foreign personal holding company income under both sections 551(b) and 951(a), Congress could have adopted any one of at least three approaches in those situations where a foreign corporation happened to be both a controlled foreign corporation and a foreign holding company.[11] It could have taxed such a corporation's United States shareholders as if the corporation were solely a foreign personal holding company. Thus, for example, the corporation's United States shareholders would not have been required to include in their gross income the corporation's increase in earnings invested in United States property since such increase is not taxed under the foreign personal holding company provisions. As an alternative, Congress could have taxed such shareholders as if the corporation were solely a controlled foreign corporation. Thus, for example, the corporation's United States shareholders in general would not have been required to include in their gross income the corporation's "rents and royalties which are derived in the active conduct of a trade or business and which are received from a person other than a related person" since such amounts are generally excluded from subpart F income under section 954(c)(3)(A).[12] Finally, Congress could have taxed such

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11. Congress could also have avoided the problem of double taxation entirely by following suggestions that the foreign personal holding company provisions be eliminated. See Hearings on H.R. 10650 Before the Senate Committee on Finance, 87th Cong., 2d Sess., pt. 6, p. 2350; pt. 7, p. 3174 (1962).

12. Note, however, that if a controlled foreign corporation's foreign base company income exceeds 70 percent of gross income, the controlled foreign corporation's entire gross income for the taxable year shall, subject to the provisions of sec. 954(b)(1), (2), (4) and (5), be treated as foreign base company income and hence will presumably be included in the gross income of the controlled foreign corporation's United States shareholders. Sec. 954(b)(3)(B).

shareholders as if the corporation were both a foreign personal holding company *and* a controlled foreign corporation. Under this third approach, it could have been provided that amounts included in a United States shareholder's gross income under both sections 551(b) and 951(a) would be included only once for the purpose of computing the United States shareholder's gross income.

While respondent and his regulations take the third approach, our examination of section 951(d) convinces us that the first approach was the one Congress intended.

In support of our conclusion we first note that as originally reported by the House Committee on Ways and Means, H. R. 10650 had substantially adopted the third approach. Thus, section 13(b)(1) of H. R. 10650 as originally passed by the House sought to modify section 551(b) so that the amount of undistributed foreign personal holding company income otherwise required under section 551(b) to be included in a United States shareholder's gross income would be reduced by his proportionate share of undistributed foreign personal holding company income which under section 951(a) would have been included in his gross income as his pro rata share of subpart F income. See also H. Rept. No. 1447, *supra* at 1962-3 C.B. 604. But this provision, which was intended to coordinate the foreign personal holding company provisions with subpart F by modifying section 551(b), was later eliminated and its role was assumed by the addition of section 951(d), which has the effect of modifying section 951(a). S. Rept. No. 1881, *supra* at 1962-3 C.B. 944.

When Congress shifted the focus of coordination from modification of section 551(b) to modification of section 951(a), did it intend, as the words of section 951(d) require, that neither a controlled foreign corporation's subpart F income *nor* its increase in earnings invested in United

States property would be included in the gross income of its United States shareholders who were already subject to tax under section 551(b) with respect to such corporation? We believe that an analysis of certain related legislative changes in the language that eventually became section 951(c) indicates that Congress did have such an intention.[13]

Section 951(c) coordinates subpart F with the election of a foreign investment company to distribute income. As originally passed in the House version of H.R. 10650, section 951(c) provided that a United States person who, for his taxable year, is a qualified shareholder of a foreign investment company with respect to which an election under section 1247 is in effect "shall not be required to include in gross income, for such taxable year, *subpart F income* of such company." (Emphasis supplied.) See also H. Rept. No. 1447, *supra* at 1962-3 C.B. 589. As changed by the Senate and as eventually enacted, section 951(c) provided that a United States shareholder who, for his taxable year, is a qualified shareholder of such company "shall not be required to include in gross income, for such taxable year, *any amount under subsection (a)* with respect to such

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13. It is significant that Congress knew that the operation of subpart F alone might have the effect of taxing greater amounts than would the operation of the foreign personal holding company provisions alone. Thus, the House had recognized that its version of subpart F might establish "stricter income tests" than the foreign personal holding company provisions. H. Rept. No. 1447, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 405, 435. As a consequence it concluded that the foreign personal holding company provisions should have been modified to conform to subpart F and wrote into H. R. 10650 at least two basic modifications of those provisions. H. Rept. No. 1447, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 405, 435-436. However, for reasons suggested at the Senate hearings on H. R. 10650, the Senate eliminated these modifications and the House eventually accepted the Senate's action. Conf. Rept. No. 2508, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 1129, 1147; see Hearings on H. R. 10650 Before the Senate Committee on finance, 87th Cong., 2d Sess. pt. 2, pp. 561-652; pt. 7, pp. 3174-3176, 3282-3283; pt. 11, pp. 4893-4894 (1962).

company." (Emphasis supplied.) The Senate Finance Committee report explaining this change specifically noted that the "corresponding provision of the bill as passed by the House applied only to subpart F income." S. Rept. No. 1881, *supra* at 1962-3 C.B. 944. That the Senate intended, by this change, to broaden the exclusion under section 951(c) strongly implies that when it added section 951(d) with its identical words of exclusion, it intended the same result.

Respondent next argues that section 951(d) "does not, even on its face, require the construction which petitioners urge."

In support of this proposition he first brings our attention to the fact that section 951(d) is entitled "Coordination with Foreign Personal Holding Company Provisions." He argues that the word "coordination" has been defined to mean "combination in suitable relation or so as to give harmonious results," that the word has been used sparingly in the Internal Revenue Code of 1954, that his research has disclosed no instance where it has been used to describe an "invariably and mutually exclusive relationship between two Code sections," and that under the above definition such use would probably be improper.

Respondent is grasping at straws.

In the first place while the heading of a section or subsection may have some bearing on the meaning of the statutory language if such language is ambiguous, e.g., *Renstorm* v. *United States*, 220 F. Supp. 688, 692 (D. Neb. 1963), we could not read the title of section 951(d) in a manner which would destroy the clear and unambiguous text of that section. Cf. sec. 7806(b). Furthermore, use of the word "coordination" in each of such sections as

sections 951(c), 992(e), 3402(n), and 7447(g) appears to describe no less "an invariably and mutually exclusive relationship between two Code sections" than does the relationship we have set forth with respect to sections 551 (b) and 951(a).[14] Finally, respondent's definition (which is only one of several definitions available in the dictionaries) does not appear inappropriate to describe the manner in which we read section 951(d) as linking subpart F to the foreign personal holding company provisions.

Respondent's final attempt to convince us of his position relates to what he perceives as an ambiguity in the words "any amount." Referring to a United States shareholder, respondent rhetorically asks, "He need not include 'any amount' of what?" and answers his own question by saying "he need not include any amount of the corporation's current income." If respondent had continued reading section 951(d), he would have realized that the proper answer to his question would have been that such a shareholder need not include "any amount under subsection (a) with respect to such company."

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14. In fact it may be open to question whether section 951(d) describes "an invariably and mutually exclusive relationship." Because the operation of sec. 951(d) is triggered by the phrase "subject to tax" sec. 951(d) could be read so that in a particular case a United States shareholder required to include amounts in his gross income under sec. 551(b) might also still be required to include in his gross income under sec. 951(a) amounts with respect to the same company. But see Tillinghast, "Problems of the Small or Closely Held Corporation Under the Revenue Act of 1962," 22d N.Y.U. Inst. on Fed. Tax 697, 717, fn. 57 (1964) (in determining if amounts should be included in a United States shareholder's gross income under sec. 951(a), it should be irrelevant whether or not the United States shareholder would actually have borne tax on the amount included under the foreign personal holding company provisions) and compare *Burke Concrete Accessories, Inc.*, 56 T.C. 588 (1971) (corporation not "entitled to benefits" of Code provision unless it could actually obtain such benefits).

Respondent fears that our construction of section 951 (d) would convert section 551 into a "relief provision."[15] However, there is no more persuasive evidence of the statute's purpose than the words by which Congress undertook to give expression to its wishes, and here examination of the legislative history does not require a different interpretation of those words. See *United States* v. *Amer. Trucking Ass'ns*, 310 U.S. 534, 543 (1940). If for any reason the language of the statute should be changed, it is the responsibility of Congress, and not the prerogative of this Court, to effect such change.

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15. Respondent suggests that if petitioner's contention is upheld, "any controlled foreign corporation could repatriate its previously retained earnings with impunity by becoming a foreign personal holding company with $1 of undistributed foreign personal holding company income in the year of repatriation." Respondent's hypothetical may not be as alarming as he would make it out to be.

While in a particular case, a United States shareholder may actively and purposefully seek to qualify his controlled foreign corporation as a foreign personal holding company in order to derive some tax advantage, in other instances unavoidable classification as a foreign personal holding company may lead to the loss of some of the benefits of subpart F. For a detailed analysis of the relative advantages and disadvantages of falling under the foreign personal holding company "regime" as opposed to the "regime" of subpart F see Tillinghast, "Problems of the Small or Closely Held Corporation Under the Revenue Act of 1962," 22d N.Y.U. Inst. on Fed. Tax 697 (1964); and Tillinghast, "United States Income Taxation of Foreign Source Income: A Survey of the Provisions and Problems," 29th N.Y.U. Inst. on Fed. Tax 1, 33-35 (1971).

A further premise of respondent's hypothetical is that becoming a foreign personal holding company is an easy matter. While in some cases, a controlled foreign corporation might easily also become a foreign personal holding company, there would be numerous instances where such conversion would be very difficult if not impossible. For instance, the stock ownership requirement under the foreign personal holding company provisions is keyed to the *value* of the foreign corporation's outstanding stock, sec. 552(a)(2), while under subpart F the stock ownership requirement looks to the *voting power* owned by United States shareholders. Sec. 957(a). Thus, United States shareholders owning all of a controlled foreign corporation's

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Because of our resolution of this issue we need not reach petitioners' alternative argument that if Oil Services' increase in earnings invested in United States property is includable in petitoners' gross income under section 951(a)(1)(B), then Oil Services' earnings and profits accumulated before 1963 should not be taken into account in calculating such increase.

2. *Taxable Year 1963*

As Oil Services was not a foreign personal holding company in 1963, petitioners for 1963 were not subject to tax under section 551(b) with respect to Oil Services. Thus, since Oil Services was a controlled foreign corporation and since it had an increase in earnings invested in United States property for 1963, petitioners were required

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Footnote continued—

voting stock might have a problem in transforming their controlled foreign corporation into a foreign personal holding company if foreign interests owned all of the other, more valuable nonvoting stock. As another example, a foreign corporation cannot be a foreign personal holding company unless the requisite amount of stock "is owned, directly or indirectly, by or for not more than five individuals who are citizens or residents of the United States." Sec. 552(a)(2). Where, for instance, a controlled foreign corporation is the foreign subsidiary of a large, public American corporation the concentrated ownership necessary to qualify as a foreign personal holding company would be inconceivable.

Finally, it is in the nature of hypotheticals that for each imaginary situation in which the Treasury is seemingly deprived of revenue there generally exists an equally shocking imaginary situation in which the taxpayer has seemingly paid more than his share. In fact, taxpayer-oriented hypotheticals bearing upon the interrelation of the foreign personal holding company provisions and subpart F and the "anomalous results" of such hypotheticals were presented at the Senate hearings on H.R. 10650. Hearings on H.R. 10650 Before the Senate Committee on Finance, 87th Cong., 2d Sess., pt. 7, pp. 3191-3194 (1962). For all we know it was these "anomalous results" which provided the Senate with the impetus to adopt sec. 951(d) and, hence, to change the House's solution to the problem of coordinating the foreign personal holding company provisions with subpart F.

under section 951(a)(1)(B) to include such increase in their gross income for 1963.

Petitioners contend that the tax imposed upon them by the operation of section 951(a)(1)(B) is unconstitutional. They have summarized their grounds for this view as follows:[16]

> Stated directly, the issue here is whether Subpart F—Controlled Foreign corporations, being Sections 951-964, at least to the extent that it attempts to impose a tax on shareholders of a controlled foreign corporation on an amount equal to the shareholder's pro-rata share of increase in earnings invested in U. S. property for a particular year involved, as outlined in Section 951(a)(1)(B) and 956(a)(1) and (2) IRC 1954, [is] invalid under the provisions of Article I,

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16. Those parts of the Constitution which are relevant to petitioners' attack provide as follows:

Art. I, sec. 2, cl. 3:

> direct Taxes shall be apportioned among the several States which may be included within this union, according to their respective Numbers, * * *

Art. I, sec. 8, cl. 1:

> The Congress shall have Power to lay and collect Taxes, * * *

Art. I, sec. 9, cl. 4:

> No capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.

Amend. V:

> nor shall any person * * * be deprived of life, liberty, or property without due process of law; * * *

Amend. XVI:

> The Congress shall have power to lay and collect taxes on income, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

Section 2, Clause 3 and 9, Clause 4, not apportioned among the states according to census and enumeration, and not within the meaning of income as referred to in the 16th Amendment to the U. S. Constitution.

Under this argument petitioners must show that the tax to which they object is both a direct tax unapportioned among the states *and* a tax on something which does not constitute income within the meaning of the 16th amendment; if they fail to show either, they must fail altogether. *Penn Mutual Indemnity Co.*, 32 T.C. 653 (1959), affd. 277 F.2d 16 (C.A. 3, 1960). Bearing in mind that every act of Congress is presumed valid and constitutional unless otherwise shown, e.g., *United States* v. *Gambling Devices*, 346 U.S. 441, 449 (1953); *Buttfield* v. *Stranahan*, 192 U.S. 470, 492 (1904), we conclude that the tax payable by petitioners on Oil Services' increase in earnings invested in United States property for 1963 is a tax on income and hence within the power given to Congress under the 16th amendment.[17]

Petitioners have based their constitutional arguments on the general operation of the statute and have posed hypothetical situations based on that operation.

Looking to the precise facts here we find that for 1963 petitioners Leonard and Georgia were husband and wife and owned all of Oil Services' stock as joint tenants with right of survivorship. In 1963 Oil Services had an increase in earnings invested in United States property. Under the statute this increase triggered inclusion in peti-

17. Our conclusion should not be taken as implying that the constitutionality of the statutory provisions in question here might not also be upheld on some other ground. Cf., e.g., Treasury Memorandum from Robert H. Knight to Secretary Dillon, Hearings on the President's 1961 Tax Recommendations Before the House Committee on Ways and Means, 87th Cong., 1st Sess., vol. 1, p. 313 (1961).

tioners' 1963 gross income of an amount equal to the increase. At the same time Oil Services' 1963 earnings and profits were appreciably larger than this increase.[18] If the amount included in petitoners' 1963 gross income under section 951(a)(1)(B) is deemed as deriving from Oil Services' 1963 earnings and profits,[19] the question we must answer boils down to whether Congress may constitutionally tax the current undistributed income of a corporation to the corporation's only two joint stockholders.

We should first point out that Oil Services' undistributed 1963 earnings and profits were as much petitioners' income as if petitioners had received such earnings and profits themselves. We emphasize this reality because petitioners' arguments imply that in certain cases the taxation of a controlled foreign corporation's minority United States stockholder on that corporation's income would be unfair or inequitable. We perceive in these arguments an attack on the statute on due process grounds. See, e.g., *Heiner* v. *Donnan*, 285 U.S. 312, 326-327 (1932) and *Hoeper* v. *Tax Commission*, 284 U.S. 206, 215 (1931). But such an attack would fail. Whether we employ a theory based on constructive receipt, e.g., *Ross* v. *Commis-*

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18. Oil Services' earnings and profits accumulated during 1963 were $26,459.99 while its increase in earnings invested in United States property for 1963 was $13,653.

19. This assumption is valid since we may view sec. 951(a)(1)(B) as taxing Oil Services' increase in earnings invested in United States property as a constructive dividend to petitioners. See Jenks, "Controlled Foreign Corporations' Investment in United States Property: A New Dividend Concept," 21 Tax L. Rev. 323, 324 (1966). Since a normal dividend would be treated as made out of a corporation's most recently accumulated earnings and profits, sec. 316(a), analogous treatment would apply to a constructive dividend. This constructive dividend theory finds support in the language of sec. 956(a)(1) which defines a controlled foreign corporation's earnings invested in United States property at the close of any taxable year as the aggregate amount of such property held to the extent such amount would have constituted a dividend if it had been distributed.

sioner, 169 F.2d 483, 490-491 (C.A. 1, 1948), alter ego, compare *National Carbide Corp.* v. *Commissioner*, 336 U.S. 422, 427-428, fn. 6 (1949) with *Moline Properties* v. *Commissioner*, 319 U.S. 436, 440 (1943) or actual command, e.g., *Higgins* v. *Smith*, 308 U.S. 473, 478 (1940), it is clear that petitioners' joint control of Oil Services' income was absolute and complete. If Congress has legislatively declared that it will bypass the corporate entity in taxing certain foreign source income, the mere circumstance of petitioners' interposition of a foreign corporate framework between themselves and income over which they had complete control would certainly be no constitutional barrier to the taxation of that income to petitioners. See *Helvering* v. *City Bank Co.*, 296 U.S. 85, 90 (1935).

Petitioners also argue that attribution of a corporation's income to its stockholders violates the basic concept that a corporation is an entity separate and distinct from its stockholders. Whatever may be the validity of that concept, the history of United States income taxation shows that Congress has for decades been drafting income tax statutes which have bypassed the corporate entity. Furthermore, the Supreme Court's pronouncements have been to the effect that taxation of undistributed current corporate income at the stockholder level rather than at the corporate level is within the Congressional power.

In *Collector* v. *Hubbard*, 12 Wall. 1 (1870), the Supreme Court held not only that Congress could tax income but also that it could tax a corporation's annual undistributed income to the corporation's shareholders. However, in *Pollock* v. *Farmers' Loan & Trust Co.*, 158 U.S. 601 (1895), supplementing 157 U.S. 429 (1895), a closely divided Supreme Court held that under an 1894 act taxes imposed on income from real or personal property were equivalent to direct taxes and were therefore unconstitu-

tional since they had not been apportioned among the states. In 1913, as an answer to *Pollock*, the 16th amendment was enacted to give Congress the "power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration."

Shortly after the enactment of the 16th amendment, Congress enacted the first modern income tax measure, the Tariff Act of 1913, 38 Stat. 114. In that act as well as in the Revenue Acts of 1916 and 1918 Congress included in stockholders' income undistributed profits accumulated by corporations availed of for the purpose of preventing imposition of surtaxes on the stockholders.[20] Sec. 220, Revenue Act of 1918, 40 Stat. 1072; Sec. 3, Revenue Act of 1916, 39 Stat. 758, sec. IIA, subdiv. 2 Tariff Act of 1913, 38 Stat. 166. Furthermore, under the Revenue Acts of 1918 and 1921 and until 1922, "personal service corporations" were not taxed, but their individual stockholders were taxed in the same manner as members of partnerships. Sec. 218(d), Revenue Act of 1921, 42 Stat. 245; sec. 218(e), Revenue Act of 1918, 40 Stat. 1070.

In 1920 the Supreme Court handed down the landmark case of *Eisner* v. *Macomber*, 252 U.S. 189 (1920), upon which petitioners place heavy reliance. The issue in *Macomber* was whether, by virtue of the 16th amendment, Congress had the power to tax, as income of the stockholder and without apportionment, a stock dividend made against a corporation's profits accumulated after February 28, 1913. In a 5-4 decision the Supreme Court decided that Congress had no such power. The reasoning was

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20. In 1921 Congress amended this provision so that the surtax on accumulations to evade tax was shifted from the stockholders to the corporation itself. Sec. 220, Revenue Act of 1921, 42 Stat. 247.

that such *accumulated* earnings constituted the stockholder's share in capital, and not income. 252 U.S. at 219. But we cannot read *Macomber* as denying to Congress the power to attribute a corporation's undistributed *current* income to the corporation's *controlling* stockholders.

In the first place the majority in *Macomber* was primarily addressing itself to situations involving corporations in which stockholders had none of the control contemplated by subpart F. Thus, the majority speaks at length of the existence and non-existence of stockholder rights in a corporation's profits and capital. 252 U.S. at 208-209. In view of the thrust of the Court's logic it is safe to say that the Court simply did not direct itself to the situation of the tightly controlled corporation where controlling stockholders are able to manipulate the corporation's profits and capital almost at will.

But, in passing, the majority did remark that a court has the power and duty to look through the form of the corporation to determine the question of stockholder rights in order to ascertain whether a stockholder had received income taxable by Congress without apportionment. 252 U.S. at 213. Thus, in matters of income taxation the *Macomber* decision would not prohibit disregard of the corporate entity if a stockholder's actual rights and powers over the corporation's income were sufficiently great. In subpart F Congress has singled out a particular class of what it considered appropriate cases for bypassing the corporate entity in determining the incidents of income taxation. By enacting this statute Congress legislatively determined that possession of a certain degree of control over the corporation gives to a stockholder certain rights and powers which, in effect, permit command over the corporation's undistributed income. Since it is clear in the instant case that petitioners had the actual right and

power to manipulate their corporation as if it were the family pocketbook, *Macomber* would be no bar to the application of that legislative determination. Cf. *Asiatic Petroleum Co.* v. *Commissioner*, 79 F.2d 234, 238 (C.A. 2, 1935) ("If anticipatory arrangements intended to circumvent taxes may be disregarded by courts without the aid of statutory authority, a statute authorizing the Commissioner to disregard them under similar circumstances cannot be unconstitutional"), certiorari denied 296 U.S. 645 (1935), affirming 31 B.T.A. 1152 (1935).

It is also important to note that the *Macomber* majority was primarily concerned with Congress' power to tax a corporation's undistributed *accumulated* earnings to the corporation's stockholders, and did not linger upon the question of congressional power to tax a corporation's *current* undistributed income to the corporation's stockholders.[21]

We conclude that, on the facts of the instant case, there is no constitutional bar to taxation of the corporation's undistributed current income to the corporation's controlling stockholders. At least two lower courts have reached constitutional issues involving the foreign personal holding company provisions and in both instances have found the provisions to be constitutionally sound. See *Eder* v. *Commissioner*, 138 F.2d 27 (C.A. 2, 1943), remanding on other grounds 47 B.T.A. 235 (1942); *Rodney* v. *Hoey*, 53 F. Supp. 604 (S.D.N.Y. 1944), and cases there cited. Originally enacted in 1937, those provisions are analogous to subpart F in that, in general, they tax United

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21. Even though we believe the operation of subpart F in the instant case is within the bounds of *Macomber*, it is significant to observe the continuing vitality of the *Macomber* doctrine is in considerable question. See, e.g., *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426 (1955); *Helvering* v. *Griffiths*, 318 U.S. 371 (1943); *Helvering* v. *Bruun*, 309 U.S. 461 (1940).

States shareholders of foreign personal holding companies on such companies' undistributed income. Most recently in *Garlock Inc.*, 58 T.C. 423 (1972), we held that the taxation to a controlled foreign corporation's United States shareholders of the corporation's subpart F income was not unconstitutional.

In light of the case law and our observations today, we go one step further and hold that as applied to the instant case the taxation to a controlled foreign corporation's United States shareholders of the corporation's increase in earnings invested in United States property is not unconstitutional.

Petitioners' final argument pertains to the availability to respondent of the six-year statute of limitations of section 6501(e)(1)(A)(ii).[22] The parties agree that petitioners omitted from their gross income $13,653 which on the face of section 951(a)(1)(B) was properly includable

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22. SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

* * *

(e) Substantial Omission of Items.—Except as otherwise provided in subsection (c)—

(1) Income taxes.—In the case of any tax imposed by subtitle A—

(A) General rule.—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed. For purposes of this subparagraph—

* * *

(ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item.

on their return for 1963 as under Oil Services' increase in earnings invested in United States property. This amount was in excess of 25 percent of the amount of gross income stated in their return. It is also clear that respondent notified petitioners of this deficiency more than three years but not more than six years after they had filed such return. The question presented is whether petitioners' return provided adequate disclosure of the omitted gross income.

In order for petitioners to come within the protection of section 6501(e)(1)(A)(ii), amounts omitted from gross income stated in the return should have been disclosed therein, or in a statement attached thereto, in a manner adequate to apprise the Commissioner "of the *nature and amount* of such item." (Emphasis supplied.) While disclosure of the type anticipated in section 6501(e)(1)(a)(ii) does not mean "a detailed revelation of each and every underlying fact," neither does it mean existence of "a 'clue' which would be sufficient to intrigue a Sherlock Holmes." *George Edward Quick Trust*, 54 T.C. 1336, 1347 (1970), affd. 444 F.2d 90 (C.A. 8, 1971). In the present case we find that the few bits of disclosed information fail to give even the vaguest clue of the nature or amount of petitioners' omission.

The only facts tending to show disclosure are three items listed on the asset side of Oil Services' balance sheet for December 31, 1963. These items were notes receivable of $47,077.49, accounts receivable of $181,924.88, and investment in common stocks of $257,500. There was no listing of Oil Services' assets as of the beginning of 1963, nor was there any indication that any part of these items constituted United States property within the meaning of section 956(b). These meager balance sheet entries were insufficient to enable respondent to determine whether

Oil Services had *any* earnings invested in United States property in 1963, much less whether it had an increase in such earnings for that year. The existence of such an increase was of course necessary for the ultimate finding that petitioners' gross income should have been augmented by the operation of section 951(a)(1)(B).

Petitioners cite such cases as *Colony, Inc.* v. *Commissioner*, 357 U.S. 28 (1958), *Benderoff* v. *United States*, 398 F. 2d 132 (C.A. 8, 1968), *Lazarus* v. *United States*, 142 F. Supp. 897 (Ct. Cl. 1956), and *Genevieve B. Walter*, 46 T.C. 630 (1966), and rely heavily on *Lyta J. Morris*, T.C. Memo 1966-245. Nothing in those cases, or in any other of the cited cases, supports petitioners' view that they had provided respondent with a clue which constituted adequate disclosure for the purposes of section 6501(e)(1)(A)(ii). In the instant case there are just too many missing fact links in the logical chain connecting the items actually disclosed to the ultimate disclosure that petitioners had omitted amounts from the gross income stated on their return.

Reviewed by the Court.

Decision will be entered under Rule 50.

SIMPSON, *J.*, dissenting: In invalidating section 1.951-3 of the Income Tax Regulations, this Court has again declined to exercise judicial restraint in the review of regulations and has chosen to assert the supremacy of its view as to the purpose of the legislation, and that view, which rests on a narrow reading of the statute, disregards the purposes of Congress in enacting the provisions for the taxation of controlled foreign corporations and will in fact frustrate such objectives. What our role should be in reviewing regulations was described by the Supreme Court

in *United States* v. *Correll*, 389 U.S. 299, 306-307 (1967), when it said:

> we do not sit as a committee of revision to perfect the administration of the tax laws. Congress has delegated to the Commissioner, not to the courts, the task of prescribing "all needful rules and regulations for the enforcement" of the Internal Revenue Code. 26 U.S.C. § 7805(a). In this area of limitless factual variations, "it is the province of Congress and the Commissioner, not the courts, to make the appropriate adjustments." *Commissioner* v. *Stidger*, 386 U.S. 287, 296. The role of the judiciary in cases of this sort begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner. * * *

See *Bingler* v. *Johnson*, 394 U.S. 741, 749-751 (1969).

The Supreme Court, in strong and unequivocal terms, has repeatedly declared that the Treasury regulations should not be struck down lightly (see, e.g., *Bingler* v. *Johnson, supra* at 394 U.S. 749-750; *Commissioner* v. *South Texas Co.*, 333 U.S. 496, 501 (1948); *Colgate Co.* v. *United States*, 320 U.S. 422, 426 (1943); *Fawcus Machine Co.* v. *United States*, 282 U.S. 375, 378 (1931); *Brewster* v. *Gage*, 280 U.S. 327, 336 (1930)), and

> it is fundamental, of course, that as "contemporaneous constructions by those charged with administration of" the Code, the Regulations "must be sustained unless unreasonable and plainly inconsistent with the revenue statutes," and "should not be overruled except for weighty reasons." *Commissioner* v. *South Texas Lumber Co.*, 333 U.S. 496, 501. * * * [*Bingler* v. *Johnson, supra* at 394 U.S. 749-750.].

See Griswold, "A Summary of the Regulations Problem," 54 Harv. L. Rev. 398, 404 (1941).

In this case, our task is to interpret section 951 and the other provisions of subpart F which result from a legislative proposal made by President Kennedy in April of 1961. The President was concerned that a number of businesses were moving abroad for tax reasons, and he wished to remove the tax advantages of doing business abroad. Hearings on the President's 1961 Tax Recommendations Before the House Committee on Ways and Means, 87th Cong., 1st Sess., Vol. 1, p. 8 (1961). He proposed to accomplish that objective by taxing, as earned, the income of foreign corporations controlled by United States citizens. *Id.* at p. 9. Congress was convinced of the need to act and adopted the President's ultimate objective, although it decided that such objective could be accomplished by less sweeping provisions. H. Rept. No. 1447, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 405, 461-462; S. Rept. No. 1881, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 707, 784-785. It believed that by taxing only certain types of income earned by controlled foreign corporations, the "tax haven" advantages of doing business abroad could be eliminated. H. Rept. No. 1447, *supra* at 1962-3 C.B. 461-462; S. Rept. No. 1881, *supra* at 1962-3 C.B. 784-785.

While Congress was considering the President's proposals, the Secretary of the Treasury and members of his staff met and conferred repeatedly with Congress concerning the taxation of controlled foreign corporations (see, e.g., Hearings, *supra* at Vol. 1, pp. 28-34, 313-322; Vol. 4, pp. 3535-3544; Hearings on H.R. 10650 Before the Senate Committee on Finance, 87th Cong., 2d Sess., pt. 1, pp. 98-99; pt. 10, pp. 4288-4289 (1962)), and after the enactment of the controlled foreign corporations provisions on October 16, 1962, the Treasury commenced the task of preparing

its implementing regulations. Those regulations were published in proposed form on July 10, 1964, and the public was given an opportunity to comment in writing and to present oral comments at a hearing. The regulations were finally adopted on January 28, 1965 (T.D. 6795).

The statutory provisions of subpart F are extremely complex, and to determine what was meant by section 951(d) and whether the regulations, section 1.951-3, properly carry out its purpose, it is necessary to understand how such provisions work in conjunction with the provisions relating to foreign personal holding companies. Secs. 551-558.

Under these circumstances, we have regulations that were issued contemporaneously with the enactment of the statute, regulations that were prepared by those who were in a position to be familiar with the objectives of the legislation, regulations interpreting extraordinarily complex provisions of the statute, and regulations developed by those officials who spent several years working with the problems of the taxation of controlled foreign corporations. In my judgment, such regulations should be given a great deal of weight by us. See, e.g., *Bingler* v. *Johnson, supra; Commissioner* v. *South Texas Co., supra.*

A careful review of the legislative history of subpart F convinces me that the Treasury had substantial reason for the regulations. While the House was considering the matter, it was apparent that there might be an overlap between the provisions relating to the foreign personal holding companies and the new provisions dealing with the taxation of controlled foreign corporations. To avoid taxing the same income twice, the House provided that income taxable under subpart F should not be taxable under section 551 relating to foreign personal holding

companies. H.R. 10650, 87th Cong., 2d Sess., sec. 13(b)(1) (1962).

In the Senate, the House provision was replaced by what is now section 951(d). However, in the report of the Senate Finance Committee, there is a discussion of the significant changes which the committee proposed to make in the House bill, and that discussion contains no reference to any change of purpose with regard to the coordination of the subpart F provisions and those relating to foreign personal holding companies. S. Rept. No. 1881, *supra* at 1962-3 C.B. 785-786. Moreover, in the general explanation of the provisions in the Finance Committee report, there is also no reference to the problem of coordinating the two sets of provisions. S. Rept. No. 1881, *supra* at 1962-3 C.B. 786-800. In the Statement of the Managers on the Part of the House accompanying the Conference Committee report, there is an extensive discussion of the changes made by the Senate, but here too there is no reference to any change in the provisions relating to the coordination of the controlled foreign corporation provisions with those relating to foreign personal holding companies. Conf. Rept. No. 2508, 87th Cong., 2d Sess. (1962), 1962-3 C.B. 1129, 1157-1164.

It is true that the technical explanation in the Finance Committee report does point out that the Senate used different words than those used by the House, but that statement does not indicate that a different result was intended by the use of different words. S. Rept. No. 1881, *supra* at 1962-3 C.B. 944. In the opinion of the majority, there is reference to the fact that section 951(c) is similar to section 951(d) and that in connection with section 951(c), the Finance Committee report pointed out that if a foreign investment company elected not to be taxed under subpart F, none of its income would be taxable under

those provisions. S. Rept. No. 1881, *supra* at 1962-3 C.B. 944. The majority infers that the committee contemplated the same result when it used similar language in section 951(d), but in connection with the explanation of section 951(d), the committee did not point out that this provision would have the same result. S. Rept. No. 1881, *supra* at 1962-3 C.B. 944. If the committee had contemplated that both provisions would have similar results, it seems as though it would have made a similar observation with respect to both provisions.

Under the House provision, it is clear that if a controlled foreign corporation made an investment in United States property or liquidated an investment in a less developed country, the investment or the proceeds of the liquidation would be taxable, even though the corporation was also a foreign personal holding company for that year. See H. R. 10650, *supra* at sec. 13(b)(1). There is nothing in the legislative history to indicate that, by the use of words different from those used in the House, the Senate intended a different result. Yet, by its holding, the majority exempts a shareholder of a controlled foreign corporation from taxation on his pro rata share of previously excluded subpart F income withdrawn from investment in less developed countries and his pro rata share of the corporation's increase in earnings invested in United States property, if the controlled foreign corporation happens also to be a foreign personal holding company during the same year. Such result is clearly significantly different from that of the House bill, and it is in conflict with the obvious intent of the Senate to tax both previously excluded income which is withdrawn from investments in less developed countries and income which is invested in United States property. S. Rept. No. 1881, *supra* at 1962-3 C.B. 785, 787, 791-794.

The frustration of such congressional purpose effectuated by the majority opinion is amply illustrated by two examples in the Income Tax Regulations. See sec. 1.951-3 examples (4) and (5). Example (4) deals with a controlled foreign corporation that makes an investment in a less developed country during a year in which it is not a foreign personal holding company and thereby defers taxation on the income so invested. In a later year, when the corporation is both a foreign personal holding company and a controlled foreign corporation, it liquidates the investment in the less developed country. It is clear that under subpart F, Congress intended to provide an incentive for investments in less developed countries by deferring taxation on income that otherwise would be currently taxable, but it is equally clear that Congress intended to tax such income if it was removed from the less developed country. H. Rept. No. 1447, *supra* at 1962-3 C.B. 461-462; S. Rept. No. 1881, *supra* at 1962-3 C.B. 785, 791. The regulations achieve that objective (see section 1.955-1(b)(2)(ii), Income Tax Regulations), but the majority holding will result in such income not being taxable when withdrawn from the less developed country.

Example (5) of the regulations deals with a situation similar to that in this case. A corporation realized foreign source income in years when it was a controlled foreign corporation but not a foreign personal holding company. In a year when it is both a foreign personal holding company and a controlled foreign corporation, it invests such previously untaxed income in United States property. The purpose of sections 951 and 956 is to tax the indirect repatriation of foreign source income by taxing such income when it is invested in United States property (H. Rept. No. 1447, *supra* at 1962-3 C.B. 462; S. Rept. No. 1881, *supra* at 1962-3 C.B. 786), and that objective is carried

out by the regulations. See secs. 1.951-3, 1.956-1(b)(2)(ii), Income Tax Regs. However, the majority holds that such income is not taxable.

Considering the undoubted intention of Congress to tax funds withdrawn from investment in less developed countries, if they have been previously excluded, and to tax funds invested in United States property, it seems clear that section 951(d) is to be applied on a year-by-year basis to the earnings of a corporation for each taxable year during which the corporation is a controlled foreign corporation. If the earnings for a year are taxed under the foreign personal holding company provisions, then such earnings were not intended to be subject to the provisions of subpart F. However, earnings not so taxed were not intended to be exempted from the operations of subpart F merely because the corporation happens to be both a foreign personal holding company and a controlled foreign corporation.

In my opinion, this Court has abrogated its responsibility by its holding in this case. It is well established that in interpreting legislation, the Court should consider not only the words of the statute, but also the effect of the proposed interpretation of those words. See, e.g., *Corn Products Co.* v. *Commissioner*, 350 U.S. 46 (1950); *Helvering* v. *Gregory*, 69 F. 2d 809 (C.A. 2, 1934), affd. 293 U.S. 465 (1935); *Estate of Robert Rodger Glen*, 45 T.C. 323 (1966). In *Corn Products Co.* v. *Commissioner, supra*, the Supreme Court held that the income which the corporation realized from trading in commodity futures should be treated as ordinary income, and not as long-term capital gains. The Court said at 350 U.S. 51-52:

> Admittedly, petitioner's corn futures do not come within the literal language of the exclusions set out

> in * * * [present section 1221]. They were not stock in trade, actual inventory, property held for sale to customers or depreciable property used in a trade or business. But the capital-asset provision * * * must not be so broadly applied as to defeat rather than further the purpose of Congress. * * *

Thus, if the proposed interpretation of a statute clearly fails to carry out the clear purpose of the legislation, then it should be rejected. See *Helvering* v. *Clifford*, 309 U.S. 331 (1940). Yet, in this case, the Court has acted in total disregard of the effect of its interpretation of section 951. To say that, "If its holding fails to accomplish the purpose of Congress, let Congress change the law," represents a failure to recognize what I consider to be our proper role. Such an attitude will impose upon Congress the necessity of enacting corrective legislation in order to avoid the frustration of its purpose. When that purpose can be gleaned as certainly as it can in this case, I believe that it is our responsibility to carry it out and not to force Congress to plug every hole that we create in the statute. I perceive that we have a higher responsibility than to interpret the statute on the basis of a narrow, literal reading of the words and to turn our back on the consequences of such an interpretation.

RAUM and DAWSON, *JJ.*, agree with this dissent.

APPENDIX B

..... F.2d ....., 74-1 USTC 9388

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

Nos. 73-1497-98

ESTATE OF LEONARD E. WHITLOCK, DECEASED, GEORGIA M. WHITLOCK, EXECUTRIX, and GEORGIA M. WHITLOCK,

Cross-Appellants, Appellees,

v.

COMMISSIONER OF INTERNAL REVENUE,

Cross-Appellee, Appellant.

On Appeal From Decision of United States Tax Court.
(Filed April 22, 1971)

Gary R. Allen, Attorney, Tax Division, Department of Justice, Washington, D. C. (Scott P. Crampton, Assistant Attorney General, Meyer Rothwacks, and Jonathan S. Cohen, Attorneys, Tax Division, Department of Justice, Washington, D. C., with him on the Brief), for Appellant.

Philip J. Erbacher, Kansas City, Missouri (R. Eugene McGannon, of Hoskins, King, McGannon, Hahn and Hurwitz, Kansas City, Missouri, with him on the Brief), for Appellees.

Before LEWIS, Chief Judge, SETH and McWILLIAMS, Circuit Judges.

SETH, Circuit Judge.

This is an appeal and cross-appeal which concern the taxation of stockholders of a controlled foreign corporation, which was also a foreign personal holding company. The issue centers on the question whether increases in earnings invested in United States property (section 951(a)(1)(B), Int.Rev.Code of 1954) by Whitlock Oil Services, Inc. should be included in taxpayers' gross income. The Commissioner assessed deficiencies based on increases in such earnings so invested. The Tax Court held that the increases should not be included by reason of section 951(d). The opinion of the Tax Court, 59 T.C. No. 48, Docket No. 386-70, and the dissenting opinion, were filed on December 29, 1972.

The taxpayers' cross-appeal raises an issue of the constitutionality of section 951(a), and a limitations question under section 6501(e)(1) of the 1954 Code for one year. The Commissioner appealed on the application made by the Tax Court of section 951(d) to exclude from the taxpayers' gross income, in determining the deficiencies, increases in earnings invested in United States property.

Whitlock Oil Services, Inc. (Oil Services) was a Panamanian corporation. The only stockholders during 1963, 1964, 1965, 1966, and 1967 were the taxpayers, or Georgia Whitlock alone after the death of her husband. Joint returns were filed. The stockholders were citizens and residents of the United States.

Oil Services during the time in question was a "controlled foreign corporation" under section 957(a) of the Internal Revenue Code of 1954. For each year except 1963, Oil Services was also a "foreign personal holding company" under section 552(a) of the 1954 Code. It had not been such a holding company before January 1, 1964.

It was stipulated that there was includable in taxpayers' gross income for each of the years 1964 through 1967 stated amounts of undistributed foreign personal holding company income from Oil Services (section 551(b)). Furthermore, it was agreed that Oil Services held investments in "United States property" under section 956(b) of the 1954 Code at the end of each year 1963 through 1967 and the increases each year were established. Under section 956(a) of the Code, the retained earnings and profits of Oil Services at all pertinent times were more than the total of its investment in United States property. Also such earnings and profits accumulated before the end of 1963.

The Commissioner by the deficiency assessments took the position that the yearly increases in earnings invested in United States property by Oil Services were includable in the gross income of the taxpayers under section 951(a)(1)(B) of the 1954 Code.

A divided Tax Court, three judges dissenting, held as to 1964, 1965, and 1967 that taxpayers were not required to include Oil Services' increases in earnings invested in United States property in their gross income for such years by reason of the language of section 951(d) of the 1954 Code, and held further that Treasury Regulations to the Contrary were invalid (Treasury Regulations on Income Tax, 1954 Code (26 C.F.R.) § 1.951-3).

The Tax Court unanimously upheld the constitutionality of the statute against taxpayers' challenge, and declared that the year 1963 was under the six-year limitation period as an instance of substantial omissions (section 6501(e)(1) of the 1954 Code).

We will consider first the increases in earnings of Oil Services invested in United States property in years when

it was a "foreign personal holding company" and also a "controlled foreign corporation." Since, except for 1963, Oil Services was within both definitions, its shareholders came within the two categories in the 1954 Code. These were sections 551-556 and sections 951-964. This litigation centers on the meaning and scope of section 951(d). This section, added by the Revenue Act of 1962 to the provisions relating to controlled foreign corporations, seeks to prevent the imposition of double taxation of stockholders when a foreign corporation is within the two definitions described above as was Oil Services. It reads as follows:

> "(d) Coordination With Foreign Personal Holding Company Provisions.—A United States shareholder who, for his taxable year, is subject to tax under section 551(b) (relating to foreign personal holding company income included in gross income of United States shareholders) on income of a controlled foreign corporation shall not be required to include in gross income, for such taxable year, any amount under subsection (a) with respect to such company."

The reference in section 951(d) to section 551(b) relating to foreign personal holding companies is to the provision which requires undistributed income of such a company to be included pro rata in the gross income of its shareholders as a dividend. Section 951(a) describes the amounts to be included in the gross income of a shareholder of a "controlled foreign corporation." Thus section 951(d) is the subsection which attempts to relate or coordinate the tax on shareholders of a corporation which is both a personal holding company and a controlled corporation.

Under existing law the earnings from year to year of a foreign personal holding company are taxed to the share-

holders, as above indicated. Thus the section 951(a) application is to earnings which accumulated in those years when the controlled foreign corporation was not a foreign personal holding company.

Section 951(a) requires to be included in the gross income of shareholders of controlled foreign corporations several different items. These are, roughly, foreign source income (section 952); provision for separate treatment of withdrawals of dividends, interest, and gains therefrom invested in "less developed countries," which was excluded subpart F income or foreign source income; and for increases in "earnings" invested in United States property (section 951(a)(1)(B)). There are thus included items of income and the somewhat different category of earnings invested. We are, of course, here concerned with the assessment for increases in earnings invested. This is an item created by the corporate decision to move funds to this country and into investments here. These were accumulated earnings of Oil Services made before 1963.

By express provisions, the computation of increases in earnings invested in United States property excludes earnings attributable to the foreign personal holding company *income* of such company. By section 551(a) amounts taxed to shareholders are as to them considered as dividends, and as to the company they are also so treated to eliminate them from the corporate earnings. Thus there is really no possibility of a second taxation of income previously taxed under the prescribed computations for section 951(a)(1)(B). There is, however, the possibility of double taxation under section 551(a) and under section 951(a)(1)(A) since both may include *income* from a foreign personal holding company. This double taxation is prevented by the express provisions of section 951(d). But does the subsection do more?

The Commissioner argues that a distinction should be made because as to *income* a possibility exists that double taxation of stockholders could take place if the corporation is in both categories, but no such possibility exists as to increases in earnings invested in United States property and income under section 551(a). This distinction, the Commissioner argues, was recognized and provided for in a Treasury Regulation. This Regulation on Income Tax § 1.951-3 was specifically directed to section 951(a)(1)(A). The text of the regulation is followed by several examples which seek to demonstrate or explain. The regulation is not particularly clear on the problem at hand, but the examples do make the distinction above described. As indicated above, the Tax Court held the regulation to be invalid as contrary to the wording of section 951(d).

The Tax Court, contrary to the argument of the Commissioner, held in substance that if the shareholder was subject to tax under section 551(b) on income he need not include in his gross income "any amount . . . with respect to such company." Thus under section 951(a)(1)(B) it held that if the personal holding company's undistributed income was included in the shareholders' gross income, then the increases in United States investments as a controlled foreign corporation need not be included. Thus the reference to "such company" freed the shareholder from tax for increases in corporate investments. This in effect exempts Oil Services' actions in repatriating earnings which are not otherwise taxed, and in circumstances where there is no possibility of double taxation of shareholders. This frees from taxation an event which is of importance in the taxation of controlled foreign corporations. The Commissioner argues that this repatriation by Oil Services of funds without taxation is thus permitted although this was one of the events sought to be met by the tax legislation relating to controlled foreign corporations.

Section 951(d) of the Internal Revenue Code of 1954 in the reference to section 551(b) describes it as covering corporate *income*, which it does, and also describes the shareholder as subject to tax on *income* of such corporation. This is a clear reference to income only, and it is corporate income to be included in the shareholders' gross income. This is clearly a device to prevent double taxation for or on "income." However, the wording can be construed, with no difficulty at all, to also immunize the other event included in section 951(a) which would otherwise be included in the shareholders' gross income—the pro rata share of the increase in the corporation's earnings invested in United States property. This event like the "income" events is just as clearly in "subsection (a)." However, it is an event, as indicated above, which cannot give rise to double taxation. It is not an "income" type item of the corporation, and the computations prevent the double tax. Thus there is no apparent explanation why this should also be excluded by section 951(d). The taxpayer has advanced no such explanation which is compatible with the overall purpose of the legislation.

The legislative history is rather extensive, but it really shows no more than the sorting of several possible devices to prevent the postponement of the inclusion of earnings in the shareholders' gross income; to cover the repatriation of earnings, and to select provisions to prevent double taxation when the foreign corporation was both a personal holding company and a controlled foreign corporation. The statute must be construed in the light of these purposes, and to meet the intention of Congress to provide an integrated coverage of the subject without voids or unexplained inconsistent treatment of essentially the same position. There is no indication that shareholders of foreign personal holding companies were to receive favored treatment.

The consideration of the purpose of the statute as a whole; the aspects of double taxation; the details of computation provided as to year by year treatment of income, and the absence of any explanation as to why the shareholders of a corporation in both classifications should receive special consideration contrary to the purpose of the Act, leads us to the conclusion that Regulation § 1.951-3 is a reasonable contemporary construction of section 951(d).

This court has had some fairly recent experience with a similar inconsistency between the wording of a tax statute and the "intent of Congress." *See* United States v. Skelly Oil Co., 394 U.S. 678; Oestereich v. Selective Service Board, 393 U.S. 233; *see also* Perry v. Commerce Loan Co., 383 U.S. 392

It would serve no useful purpose to reexamine the authorities on the matter of construction by regulations of statutory provisions by the agency charged with the execution of the legislation. These include Bingler v. Johnson, 394 U.S. 741; United States v. Correll, 389 U.S. 299; Comm'r v. South Texas Lumber Co., 333 U.S. 496; Fawcus Machine Co. v. United States, 282 U.S. 375. The dissent in the Tax Court treats these authorities and this issue in detail.

The Supreme Court has clearly stated that such a contemporaneous construction by regulation must be followed unless ". . . unreasonable and plainly inconsistent with the revenue statute." Comm'r v. South Texas Lumber Co., *supra*. We cannot hold that the regulation here concerned is plainly inconsistent with the statute, when read in the light of the overall purpose of the statute, and the obvious need not to permit voids or unexplained exceptions. Again as in Corn Products Co. v. Comm'r, 350 U.S. 46, the wording of a tax act must not be applied to

defeat the overall purpose of Congress. *See also* United States v. Correll, 389 U.S. 299. We hold that Regulation § 1.951-3 is valid, and the Tax Court must be reversed on this point. Furthermore, the regulation was directed specifically to the problem at hand, and we thus hold that it is here applicable.

The Tax Court held the provisions of subpart F (section 951(a) et seq.) constituted a constitutionally valid exercise of Congressional authority. The taxpayers had contended that the provisions violated the Fifth Amendment, and the provisions relating to direct taxes. As to due process the claim is basically that the Act ignores the separate entity of the corporation. We find no merit in this contention; it has been held otherwise as to corporate accumulated earnings. Helvering v. National Grocery Co., 304 U.S. 282, as to the "direct tax" argument. The tax here considered is computed in reference to a transaction, United States v. Manufacturers National Bank, 363 U.S. 194, an investment in United States property, and an event which came about when the taxpayers controlled the corporation. When the provisions of Article I of the Constitution, the Sixteenth Amendment, Comm'r v. Glenshaw Glass Co., 348 U.S. 426; Eisner v. Macomber, 252 U.S. 189; Pollock v. Farmers' Loan & Trust Co., 158 U.S. 601, are considered together, we find no merit to the contention that the increased earnings provision is contrary to the Constitution. We can add little to the analysis by the Tax Court of the direct tax argument and the "separate entity" arguments of the taxpayers, and agree fully therewith. *See also* Garlock, Inc. v. C.I.R., 489 F.2d 197 (2d Cir.).

Likewise we agree with the Tax Court in its conclusion and analysis of the limitations issue, the "clue" problem as to the 1963 income, and refer to its opinion on this point.

In our consideration of section 951(a)(1)(B) above, we have applied it to the earnings of Oil Services accumulated during 1962 and prior years. Section 951 is not limited by its terms to *accumulations of earnings* after 1962. It is, of course, limited to property *acquired* after 1962. This holding is consistent with the treatment of dividends if distributed. We find no basis for any other construction, and no legislative history to suggest it. Section 1248 of the Code, a related provision, contains a limitation but it is applied only to sales of stock in a controlled foreign corporation. Thus the absence of such a specific limitation in section 951(a) becomes significant. The earnings and profits accumulated between 1913 and December 31, 1962, are thus sought to be included.

The decision and judgment of the Tax Court in both cases is reversed as to the application of section 951(d) as above described, and insofar as it voided Treasury Regulation on Income Tax (1954 Code) § 1.951-3 (Coordination of Subpart F with Foerign Personal Holding Company Provisions). The decision of the Tax Court is otherwise affirmed.

APPENDIX C

MARCH TERM—APRIL 22, 1974
Before Honorable David T. Lewis, Chief Judge, Honorable Oliver Seth and Honorable Robert H. McWilliams, Circuit Judges

No. 73-1497

ESTATE OF LEONARD E. WHITLOCK, Deceased,
GEORGIA M. WHITLOCK, Executrix, and
GEORGIA M. WHITLOCK,
Petitioners-Appellees,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellant.
(Cross-Appeal)

No. 73-1498

ESTATE OF LEONARD E. WHITLOCK, Deceased,
GEORGIA M. WHITLOCK, Executrix, and
GEORGIA M. WHITLOCK,
Petitoners-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

This cause came on to be heard on the record on appeal from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is ORDERED that the judgment of the Tax Court in both cases is REVERSED as to the application of section 951(d) as described in the

text of the opinion, and insofar as it voided Treasury Regulation on Income Tax (1954 Code) § 1.951-3 (Coordination of Subpart F with Foreign Personal Holding Company Provisions). The decision of the Tax Court is otherwise AFFIRMED.

Howard K. Phillips, Clerk
By: /s/ Anne Cabot
Deputy Clerk

APPENDIX D

MAY TERM—MAY 22, 1974

Before Honorable David T. Lewis, Chief Judge, Honorable Delmas C. Hill, Honorable Oliver Seth, Honorable William J. Holloway, Jr., Honorable Robert H. McWilliams, Honorable James E. Barrett, and Honorable William E. Doyle, Circuit Judges

Nos. 73-1497
73-1498

(Cross-Appeal)

ESTATE OF LEONARD E. WHITLOCK, Deceased,
GEORGIA M. WHITLOCK, Executrix, and
GEORGIA M. WHITLOCK,
Petitioners-Appellees,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellant.

This matter comes on for consideration of the petition for rehearing and suggestion for rehearing en banc filed by the Cross Appellants-Appellees in the captioned cases.

Upon consideration whereof, the petition for rehearing is denied by Circuit Judges Lewis, Seth and McWilliams to whom the cases were argued and submitted.

The petition for rehearing having been denied by the original panel to whom the cases were argued and submitted and no member of the panel nor judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, Rule 35, Federal

Rules of Appellate Procedure, the petition for rehearing en banc is denied.

/s/ Howard K. Phillips
Howard K. Phillips
Clerk

APPENDIX E

Constitutional Provisions, Statutes, and Regulations

CONSTITUTIONAL PROVISIONS

Article I, Section 2, Clause 3 of the United States Constitution reads in part:

> "Representative and direct taxes shall be apportioned among the several States which may be included within this Union, according to their respective numbers * * *."

Article I, Section 8, Clause 1 and 3 of the United States Constitution read:

> Clause 1—"The Congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defense and general welfare of the United States; but all duties, imposts and excises shall be uniform throughout the United States;
>
> * * *
>
> Clause 3—"To regulate commerce with foreign nations, and among the several states, and with the Indian Tribes:"

Article I, Section 9, Clause 4 of the United States Constitution reads:

> "No capitation, or other direct, tax shall be laid, unless in proportion to the census or enumeration herein before directed to be taken."

AMENDMENTS TO CONSTITUTION

Fifth Amendment to the United States Constitution reads in part:

> "No person shall be deprived of * * * property without due process of law; * * *"

16th Amendment to the United States Constitution reads:

> "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

INTERNAL REVENUE CODE

Internal Revenue Code of 1954 is found in Title 26, U.S. Code. Title 26, United States Code, Section 331(a) reads:

"(a) GENERAL RULE - - -

(1) COMPLETE LIQUIDATIONS - - - Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock."

Title 26, United States Code, Section 551(a) reads:

> "(a) GENERAL RULE - - - The undistributed foreign personal holding company income of a foreign personal holding company shall be included in the gross income of the citizens or residents of the United States, domestic corporations, domestic partnerships, and estates or trusts (other than estates or trusts the gross income of which under this subtitle includes only income from sources within the United States), who are shareholders in such foreign personal holding company

(hereinafter called 'United States shareholders') in the manner and to the extent set forth in this part.

Title 26, United States Code, Section 551(b) reads:

"(b) AMOUNT INCLUDED IN GROSS INCOME - - - Each United States shareholder, who was a shareholder on the day in the taxable year of the company which was the last day on which a United States group (as defined in section 552(a)(2)) existed with respect to the company, shall include in his gross income, as a dividend, for the taxable year in which or with which the taxable year of the company ends, the amount he would have received as a dividend (determined as if any distribution in liquidation actually made in such taxable year had not been made) if on such last day there had been distributed by the company, and received by the shareholders, an amount which bears the same ratio to the undistributed foreign personal holding company income of the company for the taxable year as the portion of such taxable year up to and including such last day bears to the entire taxable year."

Title 26, United States Code, Section 951(a)(1) reads:

"(a) AMOUNTS INCLUDED - - -

(1) IN GENERAL - - - If a foreign corporation is a controlled foreign corporation for an uninterrupted period of 30 days or more during any taxable year beginning after December 31, 1962, every person who is a United States shareholder (as defined in subsection (b)) of such corporation and who owns (within the meaning of section 958(a)) stock in such corporation on the last day, in such year, on which such corporation is a controlled foreign corporation shall include in his gross income, for his taxable year in which or

with which such taxable year of the corporation ends - - -

(A) the sum of - - -

(i) except as provided in section 963, his pro rata share (determined under paragraph (2)) of the corporation's subpart F income for such year, and

(ii) his pro rata share (determined under section 955(a)(3)) of the corporation's previously excluded subpart F income withdrawn from investment in less developed countries for such year; and

(B) his pro rata share (determined under section 956(a)(2)) of the corporation's increase in earnings invested in United States property for such year (but only to the extent not excluded from gross income under section 959(a)(2))."

Title 26, United States Code, Section 951(c) reads:

"(c) COORDINATION WITH ELECTION OF A FOREIGN INVESTMENT COMPANY TO DISTRIBUTE INCOME - - - A United States shareholder who, for his taxable year, is a qualified shareholder (within the meaning of section 1247(c)) of a foreign investment company with respect to which an election under section 1247 is in effect shall not be required to include in gross income, for such taxable year, any amount under subsection (a) with respect to such company."

Title 26, United States Code, Section 951(d) reads:

"(d) COORDINATION WITH FOREIGN PERSONAL HOLDING COMPANY PROVISIONS - - - A United States shareholder who, for his taxable year, is subject to tax under section 551(b) (relating to foreign personal holding company income included in gross in-

come of United States shareholders) on income of a controlled foreign corporation shall not be required to include in gross income, for such taxable year, any amount under subsection (a) with respect to such company."

Title 26, United States Code, Section 952(a)(2) reads:

"(a) IN GENERAL - - - For purposes of this subpart, the term 'subpart F income' means, in the case of any controlled foreign corporation, the sum of - - -

(1) the income derived from the insurance of United States risks (as determined under section 953), and

(2) the foreign base company income (as determined under section 954)."

Title 26, United States Code, Section 954(a)(1) reads in part:

"(a) FOREIGN BASE COMPANY INCOME - - - For purposes of section 952(a)(2), the term 'foreign base company income' means for any taxable year the sum of - - -

(1) the foreign personal holding company income for the taxable year (determined under subsection (c) and reduced as provided in subsection (b)(5)),"

Title 26, United States Code, Sections 956(a)(1) and (2) read:

"(a) GENERAL RULES - - - For purposes of this subpart - - -

(1) AMOUNT OF INVESTMENT - - - The amount of earnings of a controlled foreign corporation invested in United States property at the close of any

taxable year is the aggregate amount of such property held, directly or indirectly, by the controlled foreign corporation at the close of the taxable year, to the extent such amount would have constituted a dividend (determined after the application of section 955(a)) if it had been distributed.

(2) PRO RATA SHARE OF INCREASE FOR YEAR - - - In the case of any United States shareholder, the pro rata share of the increase for any taxable year in the earnings of a controlled foreign corporation invested in United States property is the amount determined by subtracting his pro rata share of - - -

(A) the amount determined under paragraph (1) for the close of the preceding taxable year, reduced by amounts paid during such preceding taxable year to which section 959(c)(1) applies, from

(B) the amount determined under paragraph (1) for the close of the taxable year.

The determinations under subparagraphs (A) and (B) shall be made on the basis of stock owned (within the meaning of section 958(a)) by such United States shareholder on the last day during the taxable year on which the foreign corporation is a controlled foreign corporation."

Title 26, United States Code, Sections 956(b)(1) and (2) read in part:

"(b) UNITED STATES PROPERTY DEFINED - - -

(1) IN GENERAL - - - For purposes of subsection (a), the term 'United States property' means any property acquired after December 31, 1962, which is - - -

(A) tangible property located in the United States;

(B) stock of a domestic corporation;

(C) an obligation of a United States person; or

(D) any right to the use in the United States of - - -

(i) a patent or copyright,

(ii) an invention, model, or design (whether or not patented),

(iii) a secret formula or process, or

(iv) any other similar property right,

which is acquired or developed by the controlled foreign corporation for use in the United States

(2) EXCEPTIONS - - - For purposes of subsection (a), the term 'United States property' does not include - - -

(A) obligations of the United States, money, or deposits with persons carrying on the banking business;"

* * *

Title 26, United States Code, Section 957(a) reads:

"(a) GENERAL RULE - - - For purposes of this subpart, the term 'controlled foreign corporation' means any foreign corporation of which more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b), by United States shareholders on any day during the taxable year of such foreign corporation."

Title 26, United States Code, Section 957(d) reads in part:

"(d) UNITED STATES PERSON - - - For purposes of this subpart, the term 'United States person' has the meaning assigned to it by section 7701(a)(30) except that - - -"

Title 26, United States Code, Section 1246(a) reads:

"(a) TREATMENT OF GAIN AS ORDINARY INCOME - - -

(1) GENERAL RULE - - - In the case of a sale or exchange (or a distribution which, under section 302 or 331, is treated as an exchange of stock) after December 31, 1962, of stock in a foreign corporation which was a foreign investment company (as defined in subsection (b)) at any time during the period during which the taxpayer held such stock, any gain shall be treated as gain from the sale or exchange of property which is not a capital asset, to the extent of the taxpayer's ratable share of the earnings and profits of such corporation accumulated for the taxable years beginning after December 21, 1962."

Title 26, United States Code, Section 1247 reads in part:

"(a) ELECTION BY FOREIGN INVESTMENT COMPANY. - - -

(1) IN GENERAL. - - - If a foreign investment company which is described in section 1246(b)(1) elects (in the manner provided in regulations prescribed by the Secretary or his delegate) on or before December 31, 1962, with respect to each taxable year beginning after December 31, 1962, to - - -

(A) distribute to its shareholders 90 percent or more of what its taxable income would be if it were a domestic corporation;

(B) designate in a written notice mailed to its shareholders at any time before the expiration of 45 days after the close of its taxable year the pro rata amount of the excess (determined as if such corporation were a domestic corporation) of the net long-term capital gain over the net short-term capital loss of the taxable year; and the portion thereof which is being distributed; and

(C) provide such information as the Secretary or his delegate deems necessary to carry out the purposes of this section,

then section 1246 shall not apply with respect to the qualified shareholders of such company during any taxable year to which such election applies."

Title 26, United States Code, Section 1248(a) reads:

"(a) GENERAL RULE - - - If - - -

(1) a United States person sells or exchanges stock in a foreign corporation, or if a United States person receives a distribution from a foreign corporation which, under section 302 or 331, is treated as an exchange of stock, and

(2) such person owns, within the meaning of section 958(a), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation at any time during the 5-year period ending on the date of the sale or exchange when such foreign corporation was a controlled foreign corporation (as defined in section 957),

then the gain recognized on the sale or exchange of such stock shall be included in the gross income of such

person as a dividend, to the extent of the earnings and profits of the foreign corporation attributable (under regulations prescribed by the Secretary or his delegate) to such stock which were accumulated in taxable years of such foreign corporation beginning after December 31, 1962, and during the period or periods the stock sold or exchanged was held by such person while such foreign corporation was a controlled foreign corporation."

Title 26, United States Code, Section 6038(a)(1) reads:

"(a) REQUIREMENT - - -

(1) IN GENERAL - - - Every United States person shall furnish, with respect to any foreign corporaiton which such person controls (within the meaning of subsection (d)(1), such information as the Secretary or his delegate may prescribe by regulations relating to - - -

(A) the name, the principal place of business, and the nature of business of such foreign corporation, and the country under whose laws incorporated;

(B) the accumulated profits (as defined in section 902(c)) of such foreign corporation, including the items of income (whether or not included in gross income under chapter 1), deductions (whether or not allowed in computing taxable income under chapter 1), and any other items taken into account in computing such accumulated profits;

(C) a balance sheet for such foreign corporation listing assets, liabilities, and capital;

(D) transactions between such foreign corporation and - - -

(i) such person

(ii) any other corporation which such person controls, and

(iii) any United States person owning, at the time the transaction takes place, 10 percent or more of the value of any class of stock outstanding of such foreign corporation; and

(E) a description of the various classes of stock outstanding, and a list showing the name and address of, and number of shares held by, each United States person who is a shareholder of record owning at any time during the annual accounting period 5 percent or more in value of any class of stock outstanding of such foreign corporation.

The Secretary or his delegate may also require the furnishing of any other information which is similar or related in nature to that specified in the preceding sentence."

Title 26, United States Code, Section 6213(a) reads in part:

"(a) TIME FOR FILING PETITION AND RESTRICTION ON ASSESSMENT. - - - Within 90 days, or 150 days if the notice is addressed to a person outside the States of the Union and the District of Columbia, after the notice of deficiency authorized in section 6212 is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the last day), the taxpayer may file a petition with the Tax Court for a redetermination of the deficiency. * * *"

Title 26, United States Code, Section 6501(a) reads:

"(a) GENERAL RULE - - - Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the re-

turn was filed (whether or not such return was filed on or after the date prescribed), or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period."

Title 26, United States Code, Section 6501(e)(1)(A) reads:

"(e) SUBSTANTIAL OMISSION OF ITEMS - - - Except as otherwise provided in subsection (c) - - -

(1) INCOME TAXES - - - In the case of any tax imposed by subtitle A - - -

(A) GENERAL RULE - - - If the taxpayer omits from gross income any amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed. For purposes of this subparagraph - - -

(i) In the case of a trade or business, the term 'gross income' means the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services; and

(ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item."

Title 26, United States Code, Section 7442 reads:

"The Tax Court and its divisions shall have such jurisdiction as is conferred on them by this title, by chapters 1, 2, 3, and 4 of the Internal Revenue Code of 1939, by title II and title III of the Revenue Act of 1926 (44 Stat. 10-87), or by laws enacted subsequent to February 26, 1926."

Title 26, United States Code, Section 7482 reads in part:

"(a) JURISDICTION - - - The United States Courts of Appeals shall have exclusive jurisdiction to review the decisions of the Tax Court, except as provided in section 1254 of Title 28 of the United States Code, in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury; and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon certiorari, in the manner provided in section 1254 of Title 28 of the United States Code.

(b) VENUE - - -

(1) IN GENERAL - - - Except as otherwise provided in paragraph (2), such decisions may be reviewed by the United States court of appeals for the circuit in which is located - - -

(A) in the case of a petitioner seeking redetermination of tax liability other than a corporation, the legal residence of the petitioner,"

Title 26, United States Code, Section 7483 reads:

"Review of a decision of the Tax Court shall be obtained by filing a notice of appeal with the clerk of the Tax Court within 90 days after the decision of the Tax Court is entered. If a timely notice of appeal is

filed by one party, any other party may take an appeal by filing a notice of appeal within 120 days after the decision of the Tax Court is entered."

REGULATIONS ISSUED BY COMMISSIONER OF INTERNAL REVENUE

Regulation Sec. 1.951-1, 26 CFR, Federal Tax Regulations, U.S. Code Congressional and Administrative News (all regulations below may be found in that source) reads in part as follows:

"Amounts included in gross income of United States shareholders.

(a) In general. If a foreign corporation is a controlled foreign corporation (within the meaning of section 957) for an uninterrupted period of 30 days or more (determined under paragraph (f) of this section) during any taxable year of such corporation beginning after December 31, 1962, every person—

(1) Who is a United States shareholder (as defined in section 951(b) and paragraph (g) of this section) of such corporation at any time during such taxable year, and

(2) Who owns (within the meaning of section 958(a)) stock in such corporation on the last day in such year, on which such corporation is a controlled foreign corporation shall include in his gross income for his taxable year in which or with which such taxable year of the corporation ends, the sum of * * *"

* * *

"(iii) Such shareholder's pro rata share (determined under paragraph (d) of this section) of the corporation's increase in earnings invested in United States

property for such taxable year of the corporation (but only to the extent such pro rata share is not excluded from such shareholder's gross income for his taxable year under section 959(a)(2)."

Regulation Sec. 1.951-2, 26 CFR above, reads as follows:

"Coordination of subpart F with election of a foreign investment company to distribute income.

A United States shareholder who, for his taxable year is a qualified shareholder (within the meaning of Section 1247(c) of a foreign investment company with respect to which an election under section 1247(a) and the regulations thereunder is in effect for the taxable year of such company which ends with or within such taxable year of such shareholder shall not be required to include any amount in his gross income for his taxable year under paragraph (a) of §1.951-1 with respect to such company for that taxable year of such company."

Regulation Sec. 1.951.3, 26 CFR above, reads in part as follows:

"Coordination of subpart F with foreign personal holding company provisions.

A United States shareholder (as defined in section 951(b) who is required under section 551(b) to include in his gross income for his taxable year his share of the undistributed foreign personal holding company income for the taxable year of a foreign personal holding company (as defined in section 552) which for that taxable year is a controlled foreign corporation (as defined in section 957) shall not be required to include in his gross income for his taxable year under section 951(a) and paragraph (a) of Sec. 1.951-1 any amount

attributable to the earnings and profits of such corporation for that taxable year of such corporation. If a foreign corporation is both a foreign personal holding company and a controlled foreign corporation for the same period which is only a part of its taxable year, then, for purposes of applying the immediately preceding sentence, such corporation shall be deemed to be, for such part of such year, a foreign personal holding company and not a controlled foreign corporation and the earnings and profits of such corporation for the taxable year shall be deemed to be that amount which bears the same ratio to its earnings and profits for the taxable year as such part of the taxable year bears to the entire taxable year. The application of this section may be illustrated by the following examples:"

Example 5(a) under the preceding Regulation and which involves a corporation with undistributed foreign personal holding company income of $2,000.00 reads:

"Example (5). (a) The facts are the same as in paragraph (a) of example (4), except that, instead of having a $25,000 decrease in qualified investments in less developed countries for 1966, P Corporation invests $20,000 in tangible property (not described in section 956(b)(2)) located in the United States and such investment constitutes an increase (determined under section 956(a) but without regard to the earnings and profits of P Corporation for 1966) in earnings invested in United States property. Corporation P's earnings and profits accumulated for 1963, 1964, and 1965 and determined under paragraph (b)(1) of Sec. 1.956-1 are $22,000. The result is the same as in paragraph (a) of example (4), except that instead of including the $25,000 withdrawal, A must include $20,000 in his gross income for 1966 under section 951(a)(1)(B) and para-

graph (a)(3) of Sec. 1.951-1 as an investment of earnings in United States property."

Regulation Sec. 1.6038-2(a), 26 CFR above, reads:

"(a) Requirement of return. Every United States person shall make a separate annual information return on Form 2952 with respect to each annual accounting period (described in paragraph (e) of this section) beginning after December 31, 1962, of each foreign corporation which that person controls (as defined in paragraph (b) of this section) for an uninterrupted period of 30 days or more during such annual accounting period. Such information shall not be required to be furnished, however, with respect to a corporation defined in section 1504(b) of the Code which makes a consolidated return for the taxable year."

Regulation Sec. 1.6038-2(i), 26 CFR above, reads:

"(i) Time and place for filing return. Returns on Form 2952 required under paragraph (a) of this section shall be filed with United States person's income tax return on or before the date required by law for the filing of that person's income tax return."

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In the Supreme Court of the United States

OCTOBER TERM, 1974

No. 73-1889

ESTATE OF LEONARD E. WHITLOCK, DECEASED, ET AL.

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (Pet. App. A A1-A46) is reported at 59 T.C. 490. The opinion of the court of appeals (Pet. App. B A47-A56) is reported at 494 F.2d 1297.

JURISDICTION

The judgment of the court of appeals (Pet. App. C A57-A58) was entered on April 22, 1974, and its order denying petitioners' petition for rehearing was entered on May 22, 1974 (Pet. App. D A59-A60). The petition for a writ of certiorari was filed on June 18, 1974. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether Section 951(a)(1)(B) of the Internal Revenue Code of 1954, which requires United States shareholders of a controlled foreign corporation to include in income their share of the corporation's "increase in earnings invested in United States property," is constitutional.

2. Whether United States shareholders of a controlled foreign corporation, who are required by Section 551 of the Code to include in income their share of their corporation's undistributed foreign personal holding company income, are also subject to tax under Section 951(a)(1)(B) on their share of the corporation's increase in its investment in United States property which is made from earnings of prior years.

3. Whether the amount of a controlled foreign corporation's increase in earnings invested in United States property under Section 956(a)(2) includes all of its earnings and profits to the extent so invested and is not limited to earnings accumulated after December 31, 1962.

4. Whether petitioners' 1963 income tax return did not disclose the omission of their controlled foreign corporation's increase in earnings invested in United States property in a manner adequate to apprise the Commissioner of the nature and amount of the item within the meaning of Section 6501(e)(1)(A)(ii), so that the six-year statute of limitations was applicable to an assessment for that year.

STATUTES AND REGULATIONS INVOLVED

The pertinent portions of Sections 316, 551, 951, 952, 954, 956, 957 and 6501 of the Internal Revenue Code of 1954 (26 U.S.C.) and Section 1.951-3 of the Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.) are set forth in the Appendix, *infra*, pp. 16-30.

STATEMENT

During the years 1963-1967, petitioner Georgia M. Whitlock and her late husband, Leonard E. Whitlock, both of whom were United States citizens and residents, owned all of the stock of Whitlock Oil Services, Inc. ("Oil Services"), a Panamanian corporation which was both a "controlled foreign corporation" within the meaning of Section 957(a) of the Code for the entire period in question, and a "foreign personal holding company" as defined by Section 552 (a) of the Code for the years 1964 through 1967 (Pet. App. B A48-A49).

For each year in which it was a foreign personal holding company, Oil Services had "undistributed foreign personal holding company income" taxable in stipulated amounts to petitioners under Section 551 of the Code (Pet. App. A A7). For each of the years 1963 through 1967, Oil Services also had increased its investments in "United States property" as follows (Pet. App. A A4-A5):

Year	Total Investment in "United States property"	Increase for Year in Investment in Such Property
1963	$ 13,653.00	$ 13,653.00
1964	41,307.02	27,654.02
1965	226,034.75	184,727.73
1966	228,034.75	2,000.00
1967	453,216.08	225,181.33

At all pertinent times, Oil Services' retained earnings and profits, most of which were accumulated prior to 1963, exceeded its aggregate investment in "United States property" (Pet. App. A A6).

On audit, the Commissioner determined that these increases in investment in "United States property" were taxable to petitioners under Section 951(a)(1)(B) of the Code, which taxes such increases in investment in United States property to the United States shareholders of a "controlled foreign corporation," as that term is defined in Section 957(a) of the Code. The Tax Court unanimously upheld the constitutionality of the controlled foreign corporation provisions. It also rejected petitioners' contention that the deficiency for 1963 was barred under the general three-year limitations period of Section 6501(a) of the Code (Pet. App. A A28-A38). However, over the dissent of three judges (Pet. App. A A38-A46), the Tax Court concluded that because Oil Services was a foreign personal holding company for the years after 1963, Section 951(d) of the Code precluded the inclusion of its "increase in earnings invested in United States property" in petitioners' gross income after 1963, during which Oil Services

was a foreign personal holding company, and that the contrary provisions of Section 1.951-3 of the Treasury Regulations on Income Tax were invalid (Pet. App. A A1-A27).[1]

On cross appeals, the court of appeals rejected all of petitioners' contentions and sustained respondent's determination for all of the years in question (Pet. App. B A47-A58).

ARGUMENT

1. The courts below correctly upheld the constitutionality of Section 951(a)(1)(B) of the Code. The provisions of Section 951 through 964 of the Code were enacted in 1962[2] in order to limit the tax deferral privilege previously enjoyed by United States taxpayers with respect to the earnings of closely held foreign corporations and wholly owned foreign subsidiaries. See S. Rep. No. 1881, 87th Cong., 2d Sess., pp. 78-94. Under these provisions, United States shareholders of a "controlled foreign corporation" are subject to tax, under Section 951(a)(1)(A)(i), on certain types of current income of the corporation (referred to as "subpart F income") whether or not that income is distributed to them. Income derived by such corporations from investments in, and reinvested in, certain less developed countries is ex-

[1] The court thus did not reach petitioners' further contention that the statutory provisions should be construed to apply only to the investment of post-1962 earnings and profits (Pet. App. A A28).

[2] Revenue Act of 1962, Sec. 12, 76 Stat. 1006.

cluded from taxable Subpart F income. As a result, the statute (Section 951(a)(1)(A)(ii)) taxes the United States shareholders on these previously excluded amounts when they are withdrawn from investment in less developed countries. Moreover, Section 951(a)(1)(B) taxes such shareholders on the corporation's investment of previously untaxed earnings in various types of "United States property" as defined in Section 956(b). This element was included in the Subpart F tax base in order to ensure that such "earnings are not indirectly brought back to the United States in a manner which avoids the U.S. tax." S. Rep. No. 1881, *supra*, p. 80. See also *id.* at p. 88.

It is undisputed that Oil Services is a "controlled foreign corporation" [3] and that it had "increases in earnings invested in United States property" within the meaning of the statute. Petitioners contend (Pet. 19-20), however, that this statutory scheme under which foreign corporate earnings may be taxed to the controlling shareholders, even though not formally distributed as dividends, violates the due process clause of the Fifth Amendment and the apportionment of direct taxes clause of Article I, Section 9

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[3] Section 957(a) defines the term "controlled foreign corporation" as any foreign corporation more than 50 percent of the stock of which is owned by "United States shareholders," a term which, in turn, is defined under Sections 951(b), 957(d) and 7701(a)(30) to include any domestic corporation, partnership or trust and any United States citizen or resident who owns 10 per cent or more of the combined voting power of such a foreign corporation.

(Pet. 19). Virtually identical contentions were recently dismissed by the Second Circuit as "border-[ing] on the frivolous." *Garlock, Inc.* v. *Commissioner*, 489 F.2d 197, 202, certiorari denied, May 28, 1974, No. 73-1374.

There is no constitutional distinction between taxing the earnings of a partnership to the partners, whether or not distributed (*Heiner* v. *Mellon*, 304 U.S. 271, 280-281; *United States* v. *Basye*, 410 U.S. 441, 453-454), and taxing corporate income to stockholders of a controlled foreign corporation or foreign personal holding company. *Helvering* v. *Nat. Grocery Co.*, 304 U.S. 282, 288.[4] See also *Moline Properties* v. *Commissioner*, 319 U.S. 436, 439. Decisions of this Court have long established that where income

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[4] In *Helvering* v. *Nat. Grocery Co., supra*, the Court held constitutional the imposition of a surcharge on income of a corporation availed of for the purpose of preventing a surtax on its shareholders. The Court stated (304 U.S. at 288):

> If, having a partner, the business had been carried on as a partnership, all the year's profits would have been taxable to the partners individually, although these had been retained by the partnership undistributed. * * * Kohl, the sole owner of the business, could not by conducting it as a corporation, prevent Congress, if it chose to do so, from laying on him individually the tax on the year's profits.

Significantly, the Court cited with approval the personal holding company and accumulated earnings tax provisions which similarly tax shareholders for undistributed corporate earnings. See also *Eder* v. *Commissioner*, 138 F. 2d 27, 28 (C.A. 2). Indeed, petitioners do not challenge the constitutionality of these personal holding company provisions upon which the deficiencies were also based.

is subject to the taxpayer's dominion, power or control, the imposition of a tax is permissible and valid. *Griffiths* v. *Commissioner*, 308 U.S. 355, 357-358; *Higgins* v. *Smith*, 308 U.S. 473, 477-478; *Helvering* v. *Clifford*, 309 U.S. 331, 337; *Harrison* v. *Schaffner*, 312 U.S. 579, 580-582. The mere lack of physical receipt does not defeat the power to tax. *United States* v. *Basye, supra; Heiner* v. *Mellon, supra; Helvering* v. *Bruun*, 309 U.S. 461; *Helvering* v. *Horst*, 311 U.S. 112; *Hormel* v. *Helvering*, 312 U.S. 552.

Contrary to petitioner's argument (Pet. 19), the decision below does not conflict with *Eisner* v. *Macomber*, 252 U.S. 189. There, the Court held that it was unconstitutional under the Sixteenth Amendment to require a person to include in income a common stock dividend on common stock. Since such a dividend merely decreased the value of each share of common stock without increasing the interest of the shareholder in the corporation, it did not constitute income. The earnings of Oil Services, however, are income within the meaning of the Sixteenth Amendment, and *Eisner* v. *Macomber, supra*, does not bar the taxation of a corporation's income to a controlling shareholder as in the present case. Moreover, in *Helvering* v. *Bruun, supra*, the Court rejected the proposition that taxable gain could arise only when the taxpayer was able to sever increments from his original capital, which was one of the theoretical bases of *Eisner* v. *Macomber, supra*. See *Helvering* v. *Griffiths*, 318 U.S. 371, 393-394. See

also *Helvering* v. *Horst*, *supra*; *Commissioner* v. *Glenshaw Glass Co.*, 348 U.S. 426, 430-431; *General American Inv. Co.* v. *Commissioner*, 211 F.2d 522, 523 (C.A. 2), affirmed, 348 U.S. 434.[5]

2. Petitioners further contend (Pet. 13-18) that the decision below is contrary to Section 951(d). They assert that they are relieved from tax on Oil Services' increase in investment of earnings in United States property during the years in which it was also a foreign personal holding company. The provision upon which they rely, Section 951(d), states that a United States shareholder who is subject to tax upon his controlled foreign corporation's earnings pursuant to the foreign personal holding company provisions, "shall not be required to include in gross income, for such taxable year, any amount under [Section 951(a)] with respect to such company."

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[5] *Hoeper* v. *Tax Commission*, 284 U.S. 206, and *Heiner* v. *Donnan*, 285 U.S. 312, cited by petitioner (Pet. 20), have no bearing on the constitutionality of the controlled foreign corporation provisions. In *Hoeper*, the Court struck down a Wisconsin tax statute which assessed a husband for the combined total of his and his wife's income, even though under the law of the state, the husband had no interest in or control over his wife's income. Here, however, petitioners plainly have an interest in and control over the income of Oil Services. In *Donnan*, the Court invalidated a provision of the federal estate tax which created a conclusive presumption that gifts made within two years prior to the death of the donor were made in contemplation of death, requiring their inclusion in his gross estate. But the controlled foreign corporation provisions contain no such conclusive presumption which forecloses any consideration of the underlying facts surrounding a transaction.

As the court of appeals observed (Pet. App. B A53-A54), the purpose of Section 951(d) is readily apparent. Without such a provision, United States shareholders of foreign corporations which qualify as both controlled foreign corporations and foreign personal holding companies would be subject to tax on the same corporate income under Section 551(b), the foreign personal holding company provision, and Section 951(a)(1)(A), the controlled foreign corporation provision. But there is no overlap whatsoever between the amount of foreign personal holding company income to be included in shareholders' gross income and Section 951(a)(1)(B), which taxes the shareholders upon their controlled foreign corporation's increase in earnings invested in United States property. The latter provision applies only with respect to corporate investments made from accumulated earnings. Pursuant to Section 551(e), amounts subject to tax as foreign personal holding company income are subtracted from the corporation's earnings and profits account. Thus, no part of the earnings attributable to foreign personal holding company income could ever be included in its increase in earnings invested in United States property within the meaning of Section 951(a)(1)(B).

We acknowledge that the literal terms of Section 951(d), which speak of relief from tax of "any amount under [Section 951(a)]," could arguably be read in support of petitioner's contention. This Court, however, has recognized that the literal words of a taxing statute must not be applied to defeat the

purpose of Congress. See *Corn Products Co.* v. *Commissioner*, 350 U.S. 46. With respect to the legislative purpose, petitioners offer no suggestion as to why Congress might have wanted to favor foreign personal holding companies by allowing them freely to repatriate previously untaxed earnings in the form of investments in United States property without imposing the adverse tax consequences to which the shareholders of other types of controlled foreign corporations are generally subject. Indeed, in light of the fact that for the past 30 years, Congress has placed foreign personal holding companies in a specially disfavored status because they represented "one of the most flagrant loopholes for tax avoidance" (H. Rep. No. 1546, 75th Cong., 1st Sess., pp. 13-14), it is hardly likely that it would reverse this policy in the enactment of the controlled foreign corporation provisions without a specific reference in the legislative history. However, neither the House nor the Senate Committee report supports the existence of such a broad exemption for the shareholders of foreign personal holding companies. See H. Rep. No. 1447, 87th Cong., 2d Sess., pp. 58-60; S. Rep. No. 1881, 87th Cong., 2d Sess., p. 240.

Finally, the decision below is in accordance with Treasury Regulations, Section 1.951-3, which interprets Section 951(d) in a manner compatible with its purpose to avoid double taxation on the same corporate earnings. That Regulation states that where the undistributed earnings of a controlled foreign corporation are taxable in any year to its sharehold-

ers as foreign personal holding company income, they will not also be taxable under Subpart F as the corporation's earnings and profits for that year. However, the Regulation goes on to provide that corporate earnings of other taxable years in which it was not a foreign personal holding company remain taxable as a quasi-dividend, when invested in "United States property," to the same extent that an actual dividend distribution would be. Treasury Regulations § 1.951-3, Example (5).[6] When considered in the light of the overall purpose of the statute, this Regulation is not unreasonable or plainly inconsistent with the statute. Accordingly, the decision below correctly upheld its validity. See, *e.g.*, *Commissioner* v. *South Texas Co.*, 333 U.S. 496, 501; *Bingler* v. *Johnson*, 394 U.S. 741, 749-751; *United States* v. *Correll*, 389 U.S. 299, 306-307.

3. Petitioners' additional argument (Pet. 18-19) that Section 951(a)(1)(B), which taxes them on the increase in investment of Oil Services' earnings in United States property, applies only to post-1962 earnings and profits is without statutory support. They rely on the House version of Subpart F, which did contain such a specific limitation. See H. Rep.

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[6] See also Example (4) of the Regulation which similarly provides that the normal consequences of withdrawing previously excluded "Subpart F income" from qualifying less developed country investment cannot be avoided by qualifying the controlled foreign corporation as a foreign personal holding company. Under petitioners' construction of Section 951(d), such a wholly unwarranted tax benefit would also become available.

No. 1447, 87th Cong., 2d Sess., pp. 63-65. Petitioners fail to point out, however, that the House proposal was drastically changed by the Senate, and the version actually enacted contains no such limitation. The statute does apply only to the investment in United States property acquired after December 31, 1962 (Section 956(b)(1)), but in determining the amount includible under Section 951(a)(1)(B), Section 956(a) specifically provides that the aggregate amount of the controlled foreign corporation's investment in such property is taken into account "to the extent such amount would have constituted a dividend * * * if it had been distributed." Pursuant to Section 316(a) of the Code, the amount which would be taxable as a dividend if distributed includes all earnings and profits accumulated since February 28, 1913. As a result, the decision below correctly concluded (Pet. App. B A56) that Oil Services' retained earnings and profits accumulated prior to 1963 were properly taken into account in determining the amount of its "increase in earnings invested in United States property" for each of the years in question.

4. Finally, petitioners urge (Pet. 20-21) that the deficiency for 1963 was barred by the three-year statute of limitations. The deficiency notice for that year was issued pursuant to the special six-year limitations period provided by Section 6501(e)(1) of the Code in the case of omissions in an amount in excess of 25 percent of gross income. It is undisputed that the "increase in earnings invested in

United States property" by Oil Services that year exceeded 25 percent of the gross income reported on petitioners' return. Petitioners assert that the longer six-year statute is inapplicable under Section 6501 (e)(1)(A)(ii), which provides an exception to the special six-year limitations period where the omitted item is "disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item." The only information supplied by petitioners in this regard was an informational return (Form 2952) with respect to Oil Services. That form disclosed that Oil Services was a controlled foreign corporation and that it had assets of various types. But it did not in any way indicate that any of its assets consisted of any of the various items designated as "United States property" under Section 956(b) nor did it indicate that any of such assets had been acquired by Oil Services in the year 1963 (Pet. App. A A37-A38). Thus, this return did not adequately serve to apprise the Commissioner that there had been an omission of gross income, within the meaning of Section 6501(e)(1)(A)(ii).[7]

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[7] Nothing in *Benderoff* v. *United States*, 398 F. 2d 132, 137 (C.A. 8) (Pet. 21), is to the contrary. While the Eighth Circuit in that case spoke in terms of providing a "clue as to the omitted income," the fact of the omission, as well as its nature and amount, would have been apparent by an analysis of the returns filed by the taxpayers and their Subchapter S corporation. Nor did this Court in *Colony, Inc.* v. *Commissioner*, 357 U.S. 28 (Pet. 21), purport to establish a "clue" test less stringent than that specifically adopted by Congress

The mere fact that petitioners disclosed the existence of their controlled foreign corporation did not serve to put the Commissioner on notice that they had omitted any amount with respect to its earnings.

CONCLUSION

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

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SEPTEMBER 1974.

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in Section 6501(e). See also *Cardinal Life Insurance Co.* v. *United States*, 425 F.2d 1328 (C.A. 5).

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 316. DIVIDEND DEFINED.

(a) *General Rule.*—For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—

(1) out of the earnings and profits accumlated after February 28, 1913, or

(2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

Except as otherwise provided in this subtitle, every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits. To the extent that any distribution is, under any provision of this subchapter, treated as a distribution of property to which section 301 applies, such distribution shall be treated as a distribution of property for purposes of this subsection.

* * * *

SEC. 551. FOREIGN PERSONAL HOLDING COMPANY INCOME TAXED TO UNITED STATES SHAREHOLDERS.

(a) *General Rule.*—The undistributed foreign personal holding company income of a foreign

personal holding company shall be included in the gross income of the citizens or residents of the United States, domestic corporations, domestic partnerships, and estates or trusts (other than estates or trusts the gross income of which under this subtitle includes only income from sources within the United States), who are shareholders in such foreign personal holding company (hereinafter called "United States shareholders") in the manner and to the extent set forth in this part.

(b) [as amended by Sec. 225(f)(4), Revenue Act of 1964, P.L. 88-272, 78 Stat. 19, 88] [18] *Amount Included in Gross Income.*—Each United States shareholder, who was a shareholder on the day in the taxable year of the company which was the last day on which a United States group (as defined in section 552(a)(2)) existed with respect to the company, shall include in his gross income, as a dividend, for the taxable year in which or with which the taxable year of the company ends, the amount he would have received as a dividend (determined as if any distribution in liquidation actually made in such taxable year had not been made) if on such last day there had been distributed by the company, and received by the shareholders, an amount which bears the same ratio to the undistributed foreign personal holding company income of the company for the tax-

[18] This amendment, which added the parenthetical language "(determined as if any distribution in liquidation actually made in such taxable year had not been made)," is applicable to distributions made in any taxable year of the distributing corporation beginning after December 31, 1963. The amendment does not affect the issues in this case.

able year as the portion of such taxable year up to and including such last day bears to the entire taxable year.

* * * *

(e) *Effect on Capital Account of Foreign Personal Holding Company.*—An amount which bears the same ratio to the undistributed foreign personal holding company income of the foreign personal holding company for its taxable year as the portion of such taxable year up to and including the last day on which a United States group existed with respect to the company bears to the entire taxable year, shall, for the purpose of determining the effect of distributions in subsequent taxable years by the corporation, be considered as paid-in surplus or as a contribution to capital, and the accumulated earnings and profits as of the close of the taxable year shall be correspondingly reduced, if such amount or any portion thereof is required to be included as a dividend, directly or indirectly, in the gross income of United States shareholders.

* * * *

SEC. 951 [as added by Sec. 12(a), Revenue Act of 1962, P.L. 87-834, 76 Stat. 960, 1006]. AMOUNTS INCLUDED IN GROSS INCOME OF UNITED STATES SHAREHOLDERS.

(a) *Amounts Included.*—

(1) *In general.*—If a foreign corporation is a controlled foreign corporation for an uninterrupted period of 30 days or more during any taxable year beginning after

December 31, 1962, every person who is a United States shareholder (as defined in subsection (b)) of such corporation and who owns (within the meaning of section 958 (a)) stock in such corporation on the last day, in such year, on which such corporation is a controlled foreign corporation shall include in his gross income, for his taxable year in which or with which such taxable year of the corporation ends—

(A) the sum of—

(i) except as provided in section 963, his pro rata share (determined under paragraph (2)) of the corporation's subpart F income for such year, and

(ii) his pro rata share (determined under section 955(a)(3)) of the corporation's previously excluded subpart F income withdrawn from investment in less developed countries for such year; and

(B) his pro rata share (determined under section 956(a)(2)) of the corporation's increase in earnings invested in United States property for such year (but only to the extent not excluded from gross income under section 959(a)(2)).

* * * *

(b) *United States Shareholder Defined.*—For purposes of this subpart, the term "United States shareholder" means, with respect to any foreign corporation, a United States person (as defined in section 957(d)) who owns (within the mean-

ing of section 958(a)), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation.

* * * *

(d) *Coordination with Foreign Personal Holding Company Provisions.*—A United States shareholder who, for his taxable year, is subject to tax under section 551(b) (relating to foreign personal holding company income included in gross income of United States shareholders) on income of a controlled foreign corporation shall not be required to include in gross income, for such taxable year, any amount under subsection (a) with respect to such company.

SEC. 952 [as added by Sec. 12(a), Revenue Act of 1962, *supra*]. SUBPART F INCOME DEFINED.

(a) *In General.*—For purposes of this subpart, the term "subpart F income" means, in the case of any controlled foreign corporation, the sum of—

(1) the income derived from the insurance of United States risks (as determined under section 953), and

(2) the foreign base company income (as determined under section 954).

* * * *

SEC. 954 [as added by Sec. 12(a), Revenue Act of 1962, *supra*]. FOREIGN BASE COMPANY INCOME.

(a) *Foreign Base Company Income.*—For purposes of section 952(a)(2), the term "foreign base company income" means for any taxable year the sum of—

(1) the foreign personal holding company income for the taxable year (determined under subsection (c) and reduced as provided in subsection (b)(5)),

(2) the foreign base company sales income for the taxable year (determined under subsection (d) and reduced as provided in subsection (b)(5)), and

(3) the foreign base company services income for the taxable year (determined under subsection (e) and reduced as provided in subsection (b)(5)).

* * * *

(c) *Foreign Personal Holding Company Income—*

(1) *In general.*—For purposes of subsection (a)(1), the term "foreign personal holding company income" means the foreign personal holding company income (as defined in section 553), modified and adjusted as provided in paragraphs (2), (3), and (4).

* * * *

SEC. 956. [as added by Sec. 12(a), Revenue Act of 1962, *supra*]. INVESTMENT OF EARNINGS IN UNITED STATES PROPERTY.

(a) *General Rules.*—For purposes of this subpart—

(1) *Amount of investment.*—The amount of earnings of a controlled foreign corporation invested in United States property at the close of any taxable year is the aggregate amount of such property held, directly or indirectly, by the controlled foreign corporation at the close of the taxable year, to the extent such amount would have constituted a dividend (determined after the application of section 955(a)) if it had been distributed.

(2) *Pro rata share of increase for year.*—In the case of any United States shareholder, the pro rata share of the increase for any taxable year in the earnings of a controlled foreign corporation invested in United States property is the amount determined by subtracting his pro rata share of—

(A) the amount determined under paragraph (1) for the close of the preceding taxable year, reduced by amounts paid during such preceding taxable year to which section 959(c)(1) applies, from

(B) the amount determined under paragraph (1) for the close of the taxable year.

The determinations under subparagraph (A) and (B) shall be made on the basis of stock owned (within the meaning of section 958(a)) by such United States shareholder on the last day during the taxable year on which the foreign corporation is a controlled foreign corporation.

(3) *Amount attributable to property.*—The amount taken into account under paragraph (1) or (2) with respect to any property shall be its adjusted basis, reduced by any liability to which the property is subject.

(b) *United States Property Defined.*—

(1) *In general.*—For purposes of subsection (a), the term "United States property" means any property acquired after December 31, 1962, which is—

(A) tangible property located in the United States;

(B) stock of a domestic corporation;

(C) an obligation of a United States person; or

(D) any right to the use in the United States of—

(i) a patent or copyright,

(ii) an invention, model or design (whether or not patented),

(iii) a secret formula or process, or

(iv) any other similar property right,

which is acquired or developed by the controlled foreign corporation for use in the United States.

(2) *Exceptions.*—For purposes of subsection (a), the term "United States property" does not include—

(A) obligations of the United States, money, or deposits with persons carrying on the banking business;

(B) property located in the United States which is purchased in the United States for export to, or use in, foreign countries;

(C) any obligation of a United States person arising in connection with the sale or processing of property if the amount of such obligation outstanding at no time during the taxable year exceeds the amount which would be ordinary and necessary to carry on the trade or business of both the other party to the sale or processing transaction and the United States person had the sale or processing transaction been made between unrelated persons;

(D) any aircraft, railroad rolling stock, vessel, motor vehicle, or container used in the transportation of persons or property in foreign commerce and used predominantly outside the United States;

(E) an amount of assets of an insurance company equivalent to the unearned premiums or reserves ordinary and necessary for the proper conduct of

its insurance business attributable to contracts which are not contracts described in section 953(a)(1); and

(F) an amount of assets of the controlled foreign corporation equal to the earnings and profits accumulated after December 31, 1962, and excluded from subpart F income under section 952(b).

* * * *

SEC. 957 [as added by Sec. 12(a), Revenue Act of 1962, *supra*]. CONTROLLED FOREIGN CORPORATIONS; UNITED STATES PERSONS.

(a) *General Rule.*—For purposes of this subpart, the term "controlled foreign corporation" means any foreign corporation of which more than 50 percent of the total combined voting power of all classes of stock entitled to vote is owned (within the meaning of section 958(a)), or is considered as owned by applying the rules of ownership of section 958(b), by United States shareholders on any day during the taxable year of such foreign corporation.

* * * *

SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

* * * *

(e) [as amended by Sec. 810(b)(2), Excise Tax Reduction Act of 1965, P.L. 89-44, 79 Stat. 136, 169] *Substantial Omission of Items.*—Except as otherwise provided in subsection (c)—

(1) *Income taxes.*—In the case of any tax imposed by subtitle A—

(A) *General rule.*—If the taxpayer omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return, the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed. For purposes of this subparagraph—

(i) In the case of a trade or business, the term "gross income" means the total of the amounts received or accrued from the sale of goods or services (if such amounts are required to be shown on the return) prior to diminution by the cost of such sales or services;

(ii) In determining the amount omitted from gross income, there shall not be taken into account any amount which is omitted from gross income stated in the return if such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary or his delegate of the nature and amount of such item.

(B) *Constructive dividends.*—If the taxpayer omits from gross income an amount properly includible therein under section 551(b) (relating to the inclusion in the gross income of United

States shareholders of their distributive shares of the undistributed foreign personal holding company income), the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time within 6 years after the return was filed.

* * * *

Treasury Regulation on Income Tax (1954 Code) (26 C.F.R.):

§ *1.951-3 Coordination of subpart F with foreign personal holding company provisions.*

A United States shareholder (as defined in section 951(b)) who is required under section 551(b) to include in his gross income for his taxable year his share of the undistributed foreign personal holding company income for the taxable year of a foreign personal holding company (as defined in section 552) which for that taxable year is a controlled foreign corporation (as defined in section 957) shall not be required to include in his gross income for his taxable year under section 951(a) and paragraph (a) of § 1.951-1 any amount attributable to the earnings and profits of such corporation for that taxable year of such corporation. If a foreign corporation is both a foreign personal holding company and a controlled foreign corporation for the same period which is only a part of its taxable year, then, for purposes of applying the immediately preceding sentence, such corporation shall be deemed to be, for such part of such year, a

foreign personal holding company and not a controlled foreign corporation and the earnings and profits of such corporation for the taxable year shall be deemed to be that amount which bears the same ratio to its earnings and profits for the taxable year as such part of the taxable year bears to the entire taxable year. The application of this section may be illustrated by the following examples:

* * * *

Example (4). (a) A, a United States shareholder, owns 100 percent of the only class of stock of controlled foreign corporation P, organized on January 1, 1963. Both A and P Corporation use the calendar year as a taxable year. During 1963, 1964, and 1965, P Corporation is not a foreign personal holding company as defined in section 552(a); in each of such years, P Corporation derives dividend income of $10,000 which constitutes foreign personal holding company income (within the meaning of § 1.954-2) but under paragraph (b)(1) of § 1.954-1 excludes such amounts from foreign base company income as dividends received from, and reinvested in, qualified investments in less developed countries. Corporation P's earnings and profits accumulated for 1963, 1964, and 1965 and determined under paragraph (b)(2) of § 1.955-1 are $40,000. For 1966, P Corporation is a foreign personal holding company, has predistribution earnings and profits of $10,000, derives $10,000 of income which is both foreign personal holding company income within the meaning of section 553 and subpart F income within the meaning of section 952, distributes $8,000 to A, and has undistributed foreign personal holding company in-

come of $2,000 within the meaning of section 556. In addition, for 1966 P Corporation has a withdrawal (determined under section 955(a) but without regard to its earning and profits for such year) of $25,000 of previously excluded subpart F income from investment in less developed countries. A is required under section 551(b) to include in his gross income for 1966 as a dividend the $2,000 undistributed foreign personal holding company income. The $8,000 distribution is includible in A's gross income for 1966 under sections 61(a)(7) and 301 as a distribution to which section 316(a)(2) applies. Corporation P's $25,000 withdrawal of previously excluded subpart F income from investment in less developed countries is includible in A's gross income for 1966 under section 951(a)(1)(A)(ii) and paragraph (a)(2) of § 1.951-1.

(b) If P Corporation's earnings and profits accumulated for 1963, 1964, and 1965 were $15,000, instead of $40,000, the result would be the same as in paragraph (a) of this example, except that a withdrawal of only $15,000 of previously excluded subpart F income from investment in less developed countries would be includible in A's gross income for 1966 under section 951(a)(1)(A)(ii) and paragraph (a)(2) of § 1.951-1.

Example (5). (a) The facts are the same as in paragraph (a) of example (4), except that, instead of having a $25,000 decrease in qualified investments in less developed countries for 1966, P Corporation invests $20,000 in tangible property (not described in section 956(b)(2)) located in the United States and such investment constitutes an increase (determined under section 956

(a) but without regard to the earnings and profits of P Corporation for 1966) in earnings invested in United States property. Corporation P's earnings and profits accumulated for 1963, 1964, and 1965 and determined under paragraph (b)(1) of § 1.956-1 are $22,000. The result is the same as in paragraph (a) of example (4), except that instead of including the $25,000 withdrawal, A must include $20,000 in his gross income for 1966 under section 951(a)(1)(B) and paragraph (a)(3) of § 1.951-1 as an investment of earnings in United States property.

(b) If P Corporation's earnings and profits accumulated for 1963, 1964, and 1965 were $9,000 instead of $22,000, the result would be the same as in paragraph (a) of this example, except that only $9,000 would be includible in A's gross income for 1966 under section 951(a)(1)(B) and paragraph (a)(3) of § 1.951-1 as an investment of earnings in United States property.

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In the Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-1889

ESTATE OF LEONARD E. WHITLOCK, DECEASED
GEORGIA M. WHITLOCK, EXECUTRIX, AND
GEORGIA M. WHITLOCK,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITIONERS' BRIEF IN REPLY TO RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

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PETITIONERS' BRIEF IN REPLY TO RESPONDENT'S BRIEF IN OPPOSITION TO PETITION FOR CERTIORARI

Petitioners file this reply to that part of respondent's brief in opposition to petition for certiorari which deals with point a. (page 9 of petition), concerning interpretation of Section 951(d) IRC 1954, point k. (page 18 of petition), concerning the application of Section 951 (a) (1) (B) IRC 1954 to earnings of Oil Services accumulated during 1962 and prior years, and point n. (page 20 of petition), the constitutional issue.

With reference to point a., the correct interpretation of Section 951(d) IRC 1954, the 10th Circuit panel and the respondent both assume that the combined House and Senate did not know the meaning of Section 951(d) when the section was inserted in the law. It is submitted that the Senate, which originated the wording of Section 951(d), was fully aware that there were differences between its

views and those of the House (see the views of the Senate set out in Hearings on H.R. 10650 before Senate Finance Committee, part 2, pages 561-562, part 7, pages 3174-3176, 3282-3283, part 11, pages 4893-4894), and that these differences with respect to Section 951(d) were resolved by the Senate, in part, by the adoption of the present wording of Section 951(d). The technical explanation of the Senate's action is set out in 1962 C.B. 3, page 944, in the following language by the Senate:

> "(d) Coordination with foreign personal holding company provisions.—Subsection (d) provides that a United States shareholder who, for a taxable year, is subject to tax under section 551(b) (relating to foreign personal holding company income included in gross income of United States shareholders) on income of a controlled foreign corporation is not required to include in gross income, for such taxable year *any amount* under subsection (a) with respect to such company. The corresponding provision of the bill as passed by the House (sec. 13(b)(1)) amended section 551(b) to provide that the amount of undistributed foreign personal holding company income otherwise required under section 551(b) to be included in gross income of a United States person is reduced by his proportionate share of undistributed foreign personal holding company income included in gross income under section 951(a) for the taxable year as his proportionate share of subpart F income of such controlled foreign corporation." (Emphasis added)

The above was a part of revisions to the provisions of H.R. 10650 related to controlled foreign corporations. The Committee of Conference of the two Houses concerning the different versions of the House and Senate of H.R. 10650 issued a report No. 2508 on October 1, 1962, on the dis-

agreeing votes of the two Houses on the amendments of the Senate to H.R. 10650, of which the amendment related to controlled foreign corporations was Amendment No. 126 (see record before U.S.C.A. 10, Appendix, pp. 1 through 136, particularly pp. 139 and 140). This report is found at 1962 C.B. 3, p. 1129 and following. In the Statement of the Managers on the Part of the House, at l.c. 1157 of 1962 C.B. 3, it is stated:

> "Amendment No. 126: The bill as passed by the House added a new subpart F to part III of subchapter N of chapter 1 of the code (relating to income from sources without the United States). The new subpart F (relating to controlled foreign corporations) provided rules under which a United States person who owns stock in a controlled foreign corporation would be required to include in his gross income a pro rata share of certain portions of the controlled foreign corporation's income. Senate amendment No. 126 struck out these provisions of the bill as passed by the House and inserted new text in the nature of a substitute which adds a new subpart F (relating to controlled foreign corporations). Under the conference agreement, the House recedes with amendments, which, except as discussed below in paragraph (m) relating to receipt of minimum distributions, are either technical or clerical. The more important differences between the bill as passed by the House and the Senate amendment as agreed to in conference are explained below."

It is thus apparent that the House of Representatives was aware of the differences between the House and Senate versions of Section 951, with relation to Section 951(d) IRC 1954, and that the House receded from its version and agreed to the Senate version after giving due consideration

to same. Therefore, it cannot be said that the combined House and Senate were unaware of the impact of Section 951(d) as finally enacted.

With reference to point k. (page 20 of petition), the 10th Circuit panel has erroneously applied Section 951(a)(1)(B) IRC 1954 to earnings of Oil Services accumulated during 1962 and prior years. It erroneously stated in its opinion (page A 56 of petition) that "this holding is consistent with the treatment of dividends if distributed. We find no basis for any other construction, *and no legislative history to suggest it.*" The 10th Circuit panel was in error in so stating, since the attention of the panel was called, as has the attention of the Supreme Court been called at page 18 of petition, to House Ways and Means Committee Report #1447 to accompany H.R. 10650 found in 1962 C.B. 3, pp. 405, 461-468, at l.c. 467 wherein the Ways and Means Committee Report stated:

> "Since the concept here is merely to tax to the U.S. shareholders the earnings and profits of the corporation since the end of 1962, the investments in nonqualified property taken into account are only those which are in excess of earnings and profits accumulated in taxable years beginning after December 31, 1962."

Further, in House Ways and Means Committee Report #1447 to accompany H.R. 10650 (1962) C.B. 3, pp. 405 et sequitur, Technical Explanation of the Bill, page 588, it is stated:

> "Subpart F income may not exceed the earnings and profits for the taxable year (computed without reduction for distributions made during that year). The increase in investment in nonqualified property, however, is limited to the sum of earnings and profits

> for the taxable year (computed without reduction for distributions made during that year) plus the earnings and profits accumulated for prior taxable years *beginning after December 31, 1962.*"

The respondent seeks to argue that there is no provision in Section 951(a)(1)(B) IRC 1954 which specifically forbids the use of earnings and profits accumulated by Oil Services prior to 1963 in determining the thrust of Section 951(a)(1)(B). Both respondent and the 10th Circuit panel depart from the exact wording of Section 951(d) to refute petitioners on the main issue, while refusing to depart from the inexact wording of Section 951(a)(1)(B) relating to the earnings issue, again to refute taxpayers. Such procedure is unauthorized under the doctrine of this Court in *Harrison* v. *Northern Trust Company,* 317 U.S. 476, 63 S.Ct. 361, wherein this Court teaches that:

> "But words are inexact tools at best and for that reason there is wisely no rule of law forbidding resort to explanatory legislative history no matter how 'clear the words may appear on superficial examination.' United States v. American Trucking Assos. 310 U.S. 534, 543, * * * 60 S.Ct. 1034 * * *."

In short, petitioners request the Supreme Court to exercise the same consistency that petitioners asked for, but did not receive, from the 10th Circuit panel, i.e., if the plain wording of Section 951(d) is to be departed from, then the Court should consider the legislative history of Section 951(d) as the Tax Court did, and also consider the meaning of the not so clear wording of Section 951(a)(1)(B) on the earnings issue, by examining the legislative history of the earnings question above.

In addition, with reference to point n. (page 20 of petition), petitioners reply to that part of respondent's

brief in opposition to petition for certiorari dealing with point n., the constitutional issue. Petitioners note that the separate views of the Republicans on H.R. 10650 set out in House Committee Report #1447 to accompany H.R. 10650, found in 1962, C.B. 3, page 671 et sequitur, l.c. 687 (signed by Messrs. Noah M. Mason, John W. Byrnes, Howard H. Baker, Thomas B. Curtis, Victor A. Knox, James B. Utt, Jackson E. Betts, Bruce Alger, Steven B. Derounian, and Herman T. Schneebell), state:

> "TAX ON CONTROLLED FOREIGN CORPORATION UNCONSTITUTIONAL
>
> Section 13 of the bill has little relation to possible evasion or avoidance of U.S. tax, but is admittedly designed to reduce foreign investment. The constitutionality of this taxation of American shareholders is open to serious question. In fact, counsel for the Joint Committee on Internal Revenue Taxation has advised the committee that Congress cannot constitutionally tax shareholders on the undistributed income of foreign corporations, except in cases where such taxation is reasonably necessary to prevent evasion or avoidance of tax (Hearings before the Committee on Ways and Means, 87th Cong., 1st sess., on 'The Tax Recommendations of the President,' Apr. 20, 1961, vol. 1, pp. 311-313). The settlement of this question will produce long and costly litigation. Neither taxpayers nor the Government will know for years whether this unprecedented experiment in tax jurisdiction will be sustained by the courts."

Additionally, the respondent's brief in opposition as well as the 10th Circuit panel's decision, address themselves primarily to the constitutionality of a tax on *current year to year earnings of Oil Services*, as distinguished from

a tax on the earnings accumulated *prior to January 1, 1963*, which latter type situation is the type situation involved in *Eisner* v. *Macomber*, 252 U.S. 189, 78 S.Ct. 1033, and are thus not responsive to petitioner's argument on the constitutional issue here with reference to attempt to tax pre-1963 earnings.

CONCLUSION

WHEREFORE, petitioners again move this Court to grant Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit as requested.

Respectfully submitted,

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SUPREME COURT, U. S.

FILED

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In the Supreme Court of the United States

OCTOBER TERM, 1974

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vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR REHEARING OF ORDER DENYING PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Petitioners pray, pursuant to Rule 58.2 of this Court, that this Court grant rehearing of its order of October 15, 1974, denying the Petition for Writ of Certiorari, and that a Writ of Certiorari issue to review the judgment of the Court of Appeals for the Tenth Circuit in the above-entitled case as prayed for in the petition filed herein by the Petitioners, restricted to the *single issue* of question 1 presented in the Petition for Certiorari (page 2 of petition) as follows:

> "1. Whether, by reason of plain and explicit wording of Section 951(d) of Internal Revenue Code of 1954, Title 26, U.S.C., a United States shareholder who, for his taxable year, is subject to tax under Section 551(b) of said Revenue Code, relating to foreign personal holding company income included in gross income of United States shareholders, on income of a

controlled foreign corporation is required to include in his gross income, for such tax year, any amount under Subsection (a) of Section 951 of Internal Revenue Code of 1954 relating to inclusion in gross income, by shareholders of controlled foreign corporation, of pro rata share of increase in investments in U.S. property by controlled foreign corporation."

REASONS FOR GRANTING REHEARING AND ISSUING THE WRIT

At time that petition for certiorari was filed herein by petitioners and at time that brief in opposition thereto and reply to such brief in opposition were filed, there was no recent decision of a Court of rank equal to the Court of Appeals for the Tenth Circuit contrary to the decision of said court below in 494 F.2d 1297, specifically on the issue of the correct application of Section 951(d) IRC 1954.

However, on June 3, 1974, a refund action suit was filed in the United States Court of Claims, Washington, D. C., a court of national jurisdiction, entitled *W. R. Lovett* v. *United States*, Docket 191-74, seeking refund of income tax claimed to be overpaid by plaintiff. At paragraph 35 of the complaint in said refund action, the identical claim was made as is involved in question 1, page 2 of petition for certiorari herein, in the following language, from the *Lovett* suit:

> "35. Since for the taxable year 1963, Plaintiff is subject to tax under Section 551(b) of the Code on income of Honduras Shipping Co., S.A., plaintiff is not required under the provisions of Section 951(d) of the Code, to include in gross income, for the taxable year 1963, any amount under section 951(a) of the Code with respect to Honduras Shipping Co., S.A."

Cases in the Court of Claims may be reviewed by the Supreme Court by one of two methods (Title 28, U.S.C. 1255): by writ of certiorari granted on petition of the United States or the claimant; or, by certification of any question of law by the Court of Claims in any case as to which instructions are desired, upon which certification the Supreme Court may give binding instructions.

Thus, if the Court of Claims concludes to follow the decision of the Tax Court in 59 TC 490 (13 judges for taxpayer, 3 judges dissenting), in *Whitlock* on the Section 951(d) issue, or alternately certifies the question to the Supreme Court, the Supreme Court will be confronted with the same issue as is raised in question 1. above. Additionally, certiorari will be granted from any decision adverse to the Government on this issue in the Court of Claims (*United States* v. *Estate of Grace*, 395 U.S. 316, 89 S.Ct. 1730, opinion of six members of the Court). Further, the United States Tax Court in *Golsen*, 54 TC 742, has held that it will follow decisions of a Court of Appeals *only* in cases where appeal from a decision of the Tax Court lies to the Court of Appeals *for the same Circuit* within which the decision adverse to the Tax Court decision was granted. The Tax Court (a Court of national jurisdiction) has stated in *Golsen*, 54 TC 742, l.c. 757:

> "We shall remain able to foster uniformity by giving effect to our own views in cases appealable to courts whose views *have not yet been expressed.*" (Emphasis added)

Thus, as it now stands, both the Tax Court and the Court of Claims are free to follow views adverse to the views of the Court of Appeals for the Tenth Circuit in *Whitlock*, 494 F.2d 1297. In this connection, it should be noted that the Court of Appeals in *Whitlock* below stated at l.c. 1300:

"However, the wording can be construed, *with no difficulty at all,* to also immunize the other event included in section 951(a) which would otherwise be included in the shareholder's gross income—the pro rata share of the increase in earnings invested in United States property." (Emphasis added)

CONFLICT WITH VIEWS OF DECISION OF SUPREME COURT IN FOURCO GLASS CO. v. TRANSMIRRA PROD. CORP. ON THE PRIORITY TO BE GIVEN TO A SPECIFIC STATUTE VERSUS A GENERAL PROVISION OF STATUTE

In addition, the decision below on the application of Section 951(d) IRC 1954 is in conflict with the views of the Supreme Court noted in *Fourco Glass Co.* v. *Transmirra Prod. Corp.,* 353 U.S. 222, 77 S.Ct. 787 (case not cited before), l.c. 228:

"In these circumstances the law is settled that 'However inclusive may be the general language of a statute, it will not be held to apply to a matter specifically dealt with in another part of the same enactment.' * * * Specific terms prevail over the general in the same or another statute which otherwise might be controlling."

Thus, under *Fourco Glass Co.,* even though Section 951(a)(1)(B) would otherwise cause taxation to the shareholders of Whitlock Oil Services, Inc. of earnings invested in U.S. property, the *specific* terms of Section 951(d), which *matches* in language the *specific* terms of Section 951(c), control over general terms of Section 951(a)(1)(B) (*Fourco Glass Co.* v. *Transmirra*).

In this connection, it is noted in *"Supreme Court Practice"* by Stern and Gressman, (BNA-1969 Edition) page 154:

> "A well established ground for granting certiorari is the existence of a conflict between the decision as to which review is sought and that rendered by the Supreme Court."

By the terms of Rule 58 petitioners are limited to grounds outlined in Rule 58.2 in this petition for rehearing. Neither the pendency of the case in *Lovett* v. *United States,* Docket No. 191-74, Court of Claims, and the rules of the Court of Claims, nor the Tax Court policy on decisions of a Court of Appeals, nor the decision in *Fourco Glass Co.* v. *Transmirra,* or *United States* v. *Estate of Grace* above have previously been called to the Court's attention. Nor has the request for certiorari been previously restricted solely to *question 1 at page 2 of petition* heretofore filed.

EQUITABLE ASPECTS

It is pointed out to the Court that an ultimate decision of the Court of Claims consistent with the position of petitioners herein, followed by a later grant of certiorari by the Supreme Court in the *Lovett* litigation will be of no value to the petitioners herein, since by that time the decision of the Tenth Circuit Court of Appeals below will have become final leaving the petitioners no defense to a claim for money estimated to be in the area of a quarter of a million dollars. Petitioners' counsel have been advised by local counsel that such a situation will leave the widow, Gloria M. Whitlock, penniless and dependent, an inequitable result in view of the terms of Section 951(d) IRC 1954.

CONCLUSION

For the reasons set forth above and in the petition for writ of certiorari filed, *question 1, page 2 of petition,* and *pages 4 through 9* and *pages 12 through 18* (first two paragraphs) of petition filed, and *pages 1-3* of petitioners' brief in reply to opposition, it is respectfully urged that rehearing of order of denial be granted and that, upon such a rehearing, the order of denial be vacated and the petition for certiorari to the United States Court of Appeals for the Tenth Circuit, *limited to question 1, page 2 of petition* heretofore filed, be granted for the reasons noted.

Respectfully submitted,

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CERTIFICATE OF COUNSEL

As counsel for the petitioners, I hereby certify that this petition for rehearing is presented in good faith and not for delay and is restricted to grounds set forth in Rule 58.2 of this Court.

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